

104TH CONGRESS }  
*2d Session*

HOUSE OF REPRESENTATIVES

{ REPORT  
104-586

**SMALL BUSINESS JOB PROTECTION ACT  
OF 1996**

---

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS  
HOUSE OF REPRESENTATIVES

ON

H.R. 3448

together with

SUPPLEMENTAL AND DISSENTING VIEWS

[Together with cost estimate of the Congressional Budget Office]



MAY 20, 1996.—Committed to the Committee of the Whole House on the  
State of the Union and ordered to be printed

**SMALL BUSINESS JOB PROTECTION ACT OF 1996**

104TH CONGRESS }  
2d Session

HOUSE OF REPRESENTATIVES

{ REPORT  
104-586

**SMALL BUSINESS JOB PROTECTION ACT  
OF 1996**

---

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS  
HOUSE OF REPRESENTATIVES

ON

H.R. 3448

together with

SUPPLEMENTAL AND DISSENTING VIEWS

[Together with cost estimate of the Congressional Budget Office]



MAY 20, 1996.—Committed to the Committee of the Whole House on the  
State of the Union and ordered to be printed

---

U.S. GOVERNMENT PRINTING OFFICE

24-647

WASHINGTON : 1996



## CONTENTS

---

	Page
<b>I. INTRODUCTION .....</b>	<b>61</b>
A. Purpose and Summary .....	61
B. Background and Need for Legislation .....	61
C. Legislative History .....	62
<b>II. EXPLANATION OF THE BILL .....</b>	<b>63</b>
Small Business and Other Tax Provisions .....	63
A. Small Business Provisions .....	63
1. Increase in expensing for small businesses (sec. 1111) .....	63
2. Tax credit for Social Security taxes paid with respect to employee cash tips (sec. 1112) .....	64
3. Home office deduction: Treatment of storage of product samples (sec. 1113) .....	65
4. Treatment of certain charitable risk pools (sec. 1114) .....	66
5. Treatment of dues paid to agriculture or horticulture organizations (sec. 1115) .....	68
6. Clarify employment tax status of certain fishermen (sec. 1116(a)) .....	69
7. Reporting requirements for purchasers of fish (sec. 1116(b)) .....	70
B. Extension of Certain Expiring Provisions .....	71
1. Work opportunity tax credit (sec. 1201) .....	71
2. Employer-provided educational assistance (sec. 1202) .....	79
3. Permanent extension of FUTA exemption for alien agricultural workers (sec. 1203) .....	81
C. Provisions Relating to S Corporations .....	81
1. S corporations permitted to have 75 shareholders (sec. 1301) .....	81
2. Electing small business trusts (sec. 1302) .....	82
3. Expansion of post-death qualification for certain trusts (sec. 1303) .....	84
4. Financial institutions permitted to hold safe harbor debt (sec. 1304) .....	84
5. Rules relating to inadvertent terminations and invalid elections (sec. 1305) .....	85
6. Agreement to terminate year (sec. 1306) .....	86
7. Expansion of post-termination transition period (sec. 1307) .....	86
8. S corporations permitted to hold subsidiaries (sec. 1308) .....	87

# IV

	Page
9. Treatment of distributions during loss years (sec. 1309) .....	89
10. Treatment of S corporations under subchapter C (sec. 1310) .....	91
11. Elimination of certain earnings and profits (sec. 1311) .....	92
12. Carryover of disallowed losses and deductions under the at-risk rules (sec. 1312) .....	93
13. Adjustments to basis of inherited S stock to reflect certain items of income (sec. 1313) .....	94
14. S corporations eligible for rules applicable to real property subdivided for sale by noncorporate taxpayers (sec. 1314) .....	95
15. Reelecting subchapter S status (sec. 1315) .....	95
Pension Simplification Provisions; Foreign Simplification .....	96
A. Simplified Distribution Rules (secs. 1401–1404) .....	96
B. Increased Access to Pension Plans .....	100
1. Establish SIMPLE retirement plans (secs. 1421–1422) .....	100
2. Tax-exempt organizations eligible under section 401(k) (sec. 1426) .....	105
C. Nondiscrimination Provisions .....	105
1. Definition of highly compensated employees and repeal of family aggregation rules (sec. 1431) .....	105
2. Modification of additional participation requirements (sec. 1432) .....	107
3. Nondiscrimination rules for qualified cash or deferred arrangements and matching contributions (sec. 1433) .....	108
4. Definition of compensation for purposes of the limits on contributions and benefits (sec. 1434) .....	112
D. Miscellaneous Pension Simplification .....	112
1. Plans covering self-employed individuals (sec. 1441) .....	112
2. Elimination of special vesting rule for multi-employer plans (sec. 1442) .....	113
3. Distributions under rural cooperative plans (sec. 1443) .....	114
4. Treatment of governmental plans under section 415 (sec. 1444) .....	114
5. Uniform retirement age (sec. 1445) .....	115
6. Contributions on behalf of disabled employees (sec. 1446) .....	116
7. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations (sec. 1447) .....	116
8. Trust requirement for deferred compensation plans of State and local governments (sec. 1448) .....	117

	Page
9. Correction of GATT interest and mortality rate provisions in the Retirement Protection Act (sec. 1449) .....	118
10. Multiple salary reduction agreements permitted under section 403(b) (sec. 1450(a)) .....	119
11. Treatment of Indian tribal governments under section 403(b) (sec. 1450(b)) .....	120
12. Application of elective deferral limit to section 403(b) contracts (sec. 1450(c)) .....	121
13. Waiver of minimum waiting period for qualified plan distributions (sec. 1451) .....	121
14. Repeal of combined plan limit (sec. 1452) .....	122
15. Tax on prohibited transactions (sec. 1453) .....	123
16. Treatment of leased employees (sec. 1454) .....	124
17. Uniform penalty provisions to apply to certain pension reporting requirements (sec. 1455) .....	126
18. Retirement benefits of ministers not subject to tax on net earnings from self-employment (sec. 1456) .....	127
19. Date for adoption of plan amendments (sec. 1457) .....	127
E. Foreign Simplification Provision .....	128
1. Repeal of excess passive assets provision (sec. 1501) .....	128
Revenue Offsets .....	130
1. Phased-in repeal of Puerto Rico and possession tax credit (sec. 1601) .....	130
2. Repeal 50-percent interest income exclusion for financial institution loans to ESOPs (sec. 1602) .....	135
3. Apply look-through rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income (sec. 1603) .....	136
4. Depreciation under the income forecast method (sec. 1604) .....	138
5. Modify exclusion of damages received on account of personal injury or sickness (sec. 1605) .....	142
6. Repeal advance refunds of diesel fuel tax for purchasers of diesel-powered automobiles, vans, and light trucks (sec. 1606) .....	144
Tax Technical Corrections Provisions .....	146
A. Technical Corrections to the Revenue Reconciliation Act of 1990 .....	146
1. Excise tax provisions .....	146
a. Application of the 2.5-cents-per-gallon tax on fuel used in rail transportation to States and local governments (sec. 1702(b)(2)) .....	146
b. Small winery production credit and bonding requirements (secs. 1702(b)(5),(6), and (7)) .....	146

	Page
2. Other revenue-increase provisions of the 1990 Act .....	147
a. Deposits of Railroad Retirement Tax Act taxes (sec. 1702(c)(3)) .....	147
b. Treatment of salvage and subrogation of property and casualty insurance companies (sec. 1702(c)(4)) .....	147
c. Information with respect to certain foreign-owned or foreign corporations: Suspension of statute of limitations during certain judicial proceedings (sec. 1702(c)(5)) .....	148
d. Rate of interest for large corporate underpayments (secs. 1702(c)(6) and (7)) .....	150
3. Research credit provision: Effective date for repeal of special proration rule (sec. 1702(d)(1)) .	150
4. Energy tax provision: Alternative minimum tax adjustment based on energy preferences (secs. 1702(e)(1) and (4)) .....	151
5. Estate tax freezes (sec. 1702(f)) .....	152
6. Miscellaneous provisions .....	156
a. Conforming amendments to the repeal of the General Utilities doctrine (secs. 1702(g)(1) and (2)) .....	156
b. Prohibited transaction rules (sec. 1702(g)(3)) .....	157
c. Effective date of LIFO adjustment for purposes of computing adjusted current earnings (sec. 1702(g)(4)) .....	157
d. Low-income housing tax credit (sec. 1702(g)(5)) .....	158
7. Expired or obsolete provisions (“deadwood provisions”) (sec. 1702(h)(1)–(18)) .....	158
B. Technical Corrections to the Revenue Reconciliation Act of 1993 .....	159
1. Treatment of full-time students under the low-income housing credit (sec. 1703(b)(1)) .....	159
2. Indexation of threshold applicable to excise tax on luxury automobiles (sec. 1703(c)) .....	159
3. Indexation of the limitation based on modified adjusted gross income for income from United States savings bonds used to pay higher education tuition and fees (sec. 1703(d)) .....	160
4. Reporting and notification requirements for lobbying and political expenditures of tax-exempt organizations (sec. 1703(g)) .....	160
5. Estimated tax rules for certain tax-exempt organizations (sec. 1703(h)) .....	161
6. Current taxation of certain earnings of controlled foreign corporations—application of foreign tax credit limitations (sec. 1703(i)(1)) ..	161
7. Current taxation of certain earnings of controlled foreign corporations—measurement of accumulated earnings (sec. 1703(i)(2)) .....	162



## VII

	Page
8. Current taxation of certain earnings of controlled foreign corporations—aggregation and look-through rules (sec. 1703(i)(3)) .....	163
9. Treatment of certain leased assets for PFIC purposes (sec. 1703(i)(5)) .....	163
10. Amortization of goodwill and certain other intangibles (sec. 1703(k)) .....	164
11. Empowerment zones and eligibility of small farms for tax incentives (sec. 1703(l)) .....	165
C. Other Tax Technical Corrections .....	165
1. Hedge bonds (sec. 1704(b)) .....	165
2. Withholding on distributions from U.S. real property holding companies (sec. 1704(c)) .....	166
3. Treatment of credits attributable to working interests in oil and gas properties (sec. 1704(d)) .....	168
4. Clarification of passive loss disposition rule (sec. 1704(e)) .....	168
5. Estate tax unified credit allowed nonresident aliens under treaty (sec. 1704(f)(1)) .....	169
6. Limitation on deduction for certain interest paid by corporation to related persons (sec. 1704(f)(2)(A)) .....	170
7. Interaction between passive loss activity rules and earnings stripping rules (sec. 1704(f)(2)(B) and (C)) .....	172
8. Branch-level interest tax (sec. 1704(f)(3)) .....	173
9. Determination of source in case of sales of inventory property (sec. 1704(f)(4)) .....	174
10. Repeal of obsolete provisions (sec. 1704(f)(5)) .....	175
11. Clarification of a certain stadium bond transition rule in Tax Reform Act of 1986 (sec. 1704(g)) .....	176
12. Health care continuation rules (sec. 1704(h)) .....	176
13. Taxation of excess inclusions of a residual interest in a REMIC for taxpayers subject to alternative minimum tax with net operating losses (sec. 1704(i)) .....	177
14. Application of harbor maintenance tax to Alaska and Hawaii ship passengers (sec. 1704(j)) .....	178
15. Modify effective date provision relating to the Energy Policy Act of 1992 (sec. 1704(k)) ...	178
16. Treat qualified football coaches plan as multiemployer pension plan for purposes of the Internal Revenue Code (sec. 1704(l)) .....	179
17. Determination of unrecovered investment in annuity contract (sec. 1704(m)) .....	180
18. Election by parent to claim unearned income of certain children on parent's return (sec. 1704(n)) .....	180
19. Treatment of certain veterans' reemployment rights (sec. 1704(o)) .....	181

# VIII

	Page
20. Reporting of real estate transactions (sec. 1704(p)) .....	183
21. Clarification of denial of deduction for stock redemption expenses (sec. 1704(q)) .....	183
22. Definition of passive income in determining passive foreign investment company status (sec. 1704(s)) .....	184
23. Exclusion from income for combat zone compensation (sec. 1704(t)(4)) .....	185
24. Certain property not treated as section 179 property (sec. 1704(u)) .....	186
<b>III. VOTES OF THE COMMITTEE</b> .....	186
<b>IV. BUDGET EFFECTS OF THE BILL</b> .....	191
A. Committee Estimates of Budgetary Effects .....	191
B. Statement Regarding New Budget Authority and Tax Expenditures .....	196
C. Cost Estimate Prepared by the Congressional Budget Office .....	196
<b>V. OTHER MATTERS TO BE DISCUSSED UNDER RULES OF THE HOUSE</b> .....	200
A. Committee Oversight Findings and Recommendations .....	200
B. Summary of Findings and Recommendations of the Committee on Government Reform and Oversight .....	200
C. Inflationary Impact Statement .....	200
D. Information Relating to Unfunded Mandates .....	200
E. Applicability of House Rule XXI5(c) .....	202
<b>VI. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED</b> .....	203
<b>VII. SUPPLEMENTAL VIEWS</b> .....	396
<b>VIII. DISSENTING VIEWS</b> .....	400

## SMALL BUSINESS JOB PROTECTION ACT OF 1996

MAY 20, 1996.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

### R E P O R T

together with

### SUPPLEMENTAL AND DISSENTING VIEWS

[To accompany H.R. 3448]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 3448) to provide tax relief for small businesses, to protect jobs, to create opportunities, to increase the take home pay of workers, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment is as follows:

Strike out all after the enacting clause and insert in lieu thereof the following:

#### SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the “Small Business Job Protection Act of 1996”.

(b) TABLE OF CONTENTS.—

#### TITLE I—SMALL BUSINESS AND OTHER TAX PROVISIONS

Sec. 1101. Amendment of 1986 Code.

Sec. 1102. Underpayments of estimated tax.

#### Subtitle A—Expensing; Etc.

Sec. 1111. Increase in expense treatment for small businesses.

Sec. 1112. Treatment of employee tips.

Sec. 1113. Treatment of storage of product samples.

Sec. 1114. Treatment of certain charitable risk pools.

Sec. 1115. Treatment of dues paid to agricultural or horticultural organizations.

Sec. 1116. Clarification of employment tax status of certain fishermen; information reporting.

#### Subtitle B—Extension of Certain Expiring Provisions

Sec. 1201. Work opportunity tax credit.

- Sec. 1202. Employer-provided educational assistance programs.
- Sec. 1203. FUTA exemption for alien agricultural workers.

#### Subtitle C—Provisions Relating to S Corporations

- Sec. 1301. S corporations permitted to have 75 shareholders.
- Sec. 1302. Electing small business trusts.
- Sec. 1303. Expansion of post-death qualification for certain trusts.
- Sec. 1304. Financial institutions permitted to hold safe harbor debt.
- Sec. 1305. Rules relating to inadvertent terminations and invalid elections.
- Sec. 1306. Agreement to terminate year.
- Sec. 1307. Expansion of post-termination transition period.
- Sec. 1308. S corporations permitted to hold subsidiaries.
- Sec. 1309. Treatment of distributions during loss years.
- Sec. 1310. Treatment of S corporations under subchapter C.
- Sec. 1311. Elimination of certain earnings and profits.
- Sec. 1312. Carryover of disallowed losses and deductions under at-risk rules allowed.
- Sec. 1313. Adjustments to basis of inherited S stock to reflect certain items of income.
- Sec. 1314. S corporations eligible for rules applicable to real property subdivided for sale by noncorporate taxpayers.
- Sec. 1315. Effective date.

#### Subtitle D—Pension Simplification

##### CHAPTER 1—SIMPLIFIED DISTRIBUTION RULES

- Sec. 1401. Repeal of 5-year income averaging for lump-sum distributions.
- Sec. 1402. Repeal of \$5,000 exclusion of employees' death benefits.
- Sec. 1403. Simplified method for taxing annuity distributions under certain employer plans.
- Sec. 1404. Required distributions.

##### CHAPTER 2—INCREASED ACCESS TO PENSION PLANS

###### SUBCHAPTER A—SIMPLE SAVINGS PLANS

- Sec. 1421. Establishment of savings incentive match plans for employees of small employers.
- Sec. 1422. Extension of simple plan to 401(k) arrangements.

###### SUBCHAPTER B—OTHER PROVISIONS

- Sec. 1426. Tax-exempt organizations eligible under section 401(k).

##### CHAPTER 3—NONDISCRIMINATION PROVISIONS

- Sec. 1431. Definition of highly compensated employees; repeal of family aggregation.
- Sec. 1432. Modification of additional participation requirements.
- Sec. 1433. Nondiscrimination rules for qualified cash or deferred arrangements and matching contributions.
- Sec. 1434. Definition of compensation for section 415 purposes.

##### CHAPTER 4—MISCELLANEOUS PROVISIONS

- Sec. 1441. Plans covering self-employed individuals.
- Sec. 1442. Elimination of special vesting rule for multiemployer plans.
- Sec. 1443. Distributions under rural cooperative plans.
- Sec. 1444. Treatment of governmental plans under section 415.
- Sec. 1445. Uniform retirement age.
- Sec. 1446. Contributions on behalf of disabled employees.
- Sec. 1447. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations.
- Sec. 1448. Trust requirement for deferred compensation plans of State and local governments.
- Sec. 1449. Transition rule for computing maximum benefits under section 415 limitations.
- Sec. 1450. Modifications of section 403(b).
- Sec. 1451. Waiver of minimum period for joint and survivor annuity explanation before annuity starting date.
- Sec. 1452. Repeal of limitation in case of defined benefit plan and defined contribution plan for same employee; excess distributions.
- Sec. 1453. Tax on prohibited transactions.
- Sec. 1454. Treatment of leased employees.
- Sec. 1455. Uniform penalty provisions to apply to certain pension reporting requirements.
- Sec. 1456. Retirement benefits of ministers not subject to tax on net earnings from self-employment.
- Sec. 1457. Date for adoption of plan amendments.

#### Subtitle E—Foreign Simplification

- Sec. 1501. Repeal of inclusion of certain earnings invested in excess passive assets.

#### Subtitle F—Revenue Offsets

- Sec. 1601. Termination of Puerto Rico and possession tax credit.
- Sec. 1602. Repeal of exclusion for interest on loans used to acquire employer securities.
- Sec. 1603. Certain amounts derived from foreign corporations treated as unrelated business taxable income.
- Sec. 1604. Depreciation under income forecast method.
- Sec. 1605. Repeal of exclusion for punitive damages and for damages not attributable to physical injuries or sickness.
- Sec. 1606. Repeal of diesel fuel tax rebate to purchasers of diesel-powered automobiles and light trucks.

#### Subtitle G—Technical Corrections

- Sec. 1701. Coordination with other subtitles.
- Sec. 1702. Amendments related to Revenue Reconciliation Act of 1990.
- Sec. 1703. Amendments related to Revenue Reconciliation Act of 1993.
- Sec. 1704. Miscellaneous provisions.

## TITLE I—SMALL BUSINESS AND OTHER TAX PROVISIONS

### SEC. 1101. AMENDMENT OF 1986 CODE.

Except as otherwise expressly provided, whenever in this title an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

### SEC. 1102. UNDERPAYMENTS OF ESTIMATED TAX.

No addition to the tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1986 (relating to failure to pay estimated tax) with respect to any underpayment of an installment required to be paid before the date of the enactment of this Act to the extent such underpayment was created or increased by any provision of this title.

## Subtitle A—Expensing; Etc.

### SEC. 1111. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.

(a) GENERAL RULE.—Paragraph (1) of section 179(b) (relating to dollar limitation) is amended to read as follows:

“(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed the following applicable amount:

“If the taxable year begins in:	The applicable amount is:
1996 .....	\$18,500
1997 .....	19,000
1998 .....	20,000
1999 .....	21,000
2000 .....	22,000
2001 .....	23,000
2002 .....	23,500
2003 or thereafter .....	25,000.”

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1995.

### SEC. 1112. TREATMENT OF EMPLOYEE TIPS.

(a) EMPLOYEE CASH TIPS.—

(1) REPORTING REQUIREMENT NOT CONSIDERED.—Subparagraph (A) of section 45B(b)(1) (relating to excess employer social security tax) is amended by inserting “without regard to whether such tips are reported under section 6053)” after “section 3121(q)”.

(2) TAXES PAID.—Subsection (d) of section 13443 of the Revenue Reconciliation Act of 1993 is amended by inserting “, with respect to services performed before, on, or after such date” after “1993”.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect as if included in the amendments made by, and the provisions of, section 13443 of the Revenue Reconciliation Act of 1993.

(b) TIPS FOR EMPLOYEES DELIVERING FOOD OR BEVERAGES.—

(1) IN GENERAL.—Paragraph (2) of section 45B(b) is amended to read as follows:

“(2) ONLY TIPS RECEIVED FOR FOOD OR BEVERAGES TAKEN INTO ACCOUNT.—In applying paragraph (1), there shall be taken into account only tips received from customers in connection with the delivering or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to tips received for services performed after December 31, 1996.

### SEC. 1113. TREATMENT OF STORAGE OF PRODUCT SAMPLES.

(a) IN GENERAL.—Paragraph (2) of section 280A(c) is amended by striking “inventory” and inserting “inventory or product samples”.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1995.

**SEC. 1114. TREATMENT OF CERTAIN CHARITABLE RISK POOLS.**

(a) **GENERAL RULE.**—Section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

“(n) **CHARITABLE RISK POOLS.**—

“(1) **IN GENERAL.**—For purposes of this title—

“(A) a qualified charitable risk pool shall be treated as an organization organized and operated exclusively for charitable purposes, and

“(B) subsection (m) shall not apply to a qualified charitable risk pool.

“(2) **QUALIFIED CHARITABLE RISK POOL.**—For purposes of this subsection, the term ‘qualified charitable risk pool’ means any organization—

“(A) which is organized and operated solely to pool insurable risks of its members (other than risks related to medical malpractice) and to provide information to its members with respect to loss control and risk management,

“(B) which is comprised solely of members that are organizations described in subsection (c)(3) and exempt from tax under subsection (a), and

“(C) which meets the organizational requirements of paragraph (3).

“(3) **ORGANIZATIONAL REQUIREMENTS.**—An organization (hereinafter in this subsection referred to as the ‘risk pool’) meets the organizational requirements of this paragraph if—

“(A) such risk pool is organized as a nonprofit organization under State law provisions authorizing risk pooling arrangements for charitable organizations,

“(B) such risk pool is exempt from any income tax imposed by the State (or will be so exempt after such pool qualifies as an organization exempt from tax under this title),

“(C) such risk pool has obtained at least \$1,000,000 in startup capital from nonmember charitable organizations,

“(D) such risk pool is controlled by a board of directors elected by its members, and

“(E) the organizational documents of such risk pool require that—

“(i) each member of such pool shall at all times be an organization described in subsection (c)(3) and exempt from tax under subsection (a),

“(ii) any member which receives a final determination that it no longer qualifies as an organization described in subsection (c)(3) shall immediately notify the pool of such determination and the effective date of such determination, and

“(iii) each policy of insurance issued by the risk pool shall provide that such policy will not cover the insured with respect to events occurring after the date such final determination was issued to the insured.

An organization shall not cease to qualify as a qualified charitable risk pool solely by reason of the failure of any of its members to continue to be an organization described in subsection (c)(3) if, within a reasonable period of time after such pool is notified as required under subparagraph (C)(ii), such pool takes such action as may be reasonably necessary to remove such member from such pool.

“(4) **OTHER DEFINITIONS.**—For purposes of this subsection—

“(A) **STARTUP CAPITAL.**—The term ‘startup capital’ means any capital contributed to, and any program-related investments (within the meaning of section 4944(c)) made in, the risk pool before such pool commences operations.

“(B) **NONMEMBER CHARITABLE ORGANIZATION.**—The term ‘nonmember charitable organization’ means any organization which is described in subsection (c)(3) and exempt from tax under subsection (a) and which is not a member of the risk pool and does not benefit (directly or indirectly) from the insurance coverage provided by the pool to its members.”

(b) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

**SEC. 1115. TREATMENT OF DUES PAID TO AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS.**

(a) **GENERAL RULE.**—Section 512 (defining unrelated business taxable income) is amended by adding at the end thereof the following new subsection:

“(d) **TREATMENT OF DUES OF AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS.**—

“(1) **IN GENERAL.**—If—

“(A) an agricultural or horticultural organization described in section 501(c)(5) requires annual dues to be paid in order to be a member of such organization, and

“(B) the amount of such required annual dues does not exceed \$100, in no event shall any portion of such dues be treated as derived by such organization from an unrelated trade or business by reason of any benefits or privileges to which members of such organization are entitled.

“(2) INDEXATION OF \$100 AMOUNT.—In the case of any taxable year beginning in a calendar year after 1995, the \$100 amount in paragraph (1) shall be increased by an amount equal to—

“(A) \$100, multiplied by

“(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting ‘calendar year 1994’ for ‘calendar year 1992’ in subparagraph (B) thereof.

“(3) DUES.—For purposes of this subsection, the term ‘dues’ includes any payment required to be made in order to be recognized by the organization as a member of the organization.”

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1994.

**SEC. 1116. CLARIFICATION OF EMPLOYMENT TAX STATUS OF CERTAIN FISHERMEN; INFORMATION REPORTING.**

(a) CLARIFICATION OF EMPLOYMENT TAX STATUS.—

(1) AMENDMENTS OF INTERNAL REVENUE CODE OF 1986.—

(A) DETERMINATION OF SIZE OF CREW.—Subsection (b) of section 3121 (defining employment) is amended by adding at the end thereof the following new sentence:

“For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.”

(B) CERTAIN CASH REMUNERATION PERMITTED.—Subparagraph (A) of section 3121(b)(20) is amended to read as follows:

“(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—

“(i) which does not exceed \$100 per trip;

“(ii) which is contingent on a minimum catch; and

“(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry.”.

(C) CONFORMING AMENDMENT.—Section 6050A(a) is amended by striking “and” at the end of paragraph (3), by striking the period at the end of paragraph (4) and inserting “; and”, and by adding at the end thereof the following new paragraph:

“(5) any cash remuneration described in section 3121(b)(20)(A).”

(2) AMENDMENT OF SOCIAL SECURITY ACT.—

(A) DETERMINATION OF SIZE OF CREW.—Subsection (a) of section 210 of the Social Security Act is amended by adding at the end thereof the following new sentence:

“For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.”

(B) CERTAIN CASH REMUNERATION PERMITTED.—Subparagraph (A) of section 210(a)(20) of such Act is amended to read as follows:

“(A) such individual does not receive any additional compensation other than as provided in subparagraph (B) and other than cash remuneration—

“(i) which does not exceed \$100 per trip;

“(ii) which is contingent on a minimum catch; and

“(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry.”.

(3) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendments made by this subsection shall apply to remuneration paid after December 31, 1996.

(B) SPECIAL RULE.—The amendments made by this subsection (other than paragraph (1)(C)) shall also apply to remuneration paid after December 31, 1984, and before January 1, 1997, unless the payor treated such remunera-

tion (when paid) as being subject to tax under chapter 21 of the Internal Revenue Code of 1986.

(b) INFORMATION REPORTING.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 68 (relating to information concerning transactions with other persons) is amended by adding at the end the following new section:

**“SEC. 6050Q. RETURNS RELATING TO CERTAIN PURCHASES OF FISH.**

“(a) REQUIREMENT OF REPORTING.—Every person—

“(1) who is engaged in the trade or business of purchasing fish for resale from any person engaged in the trade or business of catching fish; and

“(2) who makes payments in cash in the course of such trade or business to such a person of \$600 or more during any calendar year for the purchase of fish, shall make a return (at such times as the Secretary may prescribe) described in subsection (b) with respect to each person to whom such a payment was made during such calendar year.

“(b) RETURN.—A return is described in this subsection if such return—

“(1) is in such form as the Secretary may prescribe, and

“(2) contains—

“(A) the name, address, and TIN of each person to whom a payment described in subsection (a)(2) was made during the calendar year;

“(B) the aggregate amount of such payments made to such person during such calendar year and the date and amount of each such payment, and

“(C) such other information as the Secretary may require.

“(c) STATEMENT TO BE FURNISHED WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

“(1) the name and address of the person required to make such a return, and

“(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) is required to be made.

“(d) DEFINITIONS.—For purposes of this section:

“(1) CASH.—The term ‘cash’ has the meaning given such term by section 6050I(d).

“(2) FISH.—The term ‘fish’ includes other forms of aquatic life.”.

(2) TECHNICAL AMENDMENTS.—

(A) Subparagraph (A) of section 6724(d)(1) is amended by striking “or” at the end of clause (vi), by striking “and” at the end of clause (vii) and inserting “or”, and by adding at the end the following new clause:

“(viii) section 6050Q (relating to returns relating to certain purchases of fish), and”.

(B) Paragraph (2) of section 6724(d) is amended by redesignating subparagraphs (Q) through (T) as subparagraphs (R) through (U), respectively, and by inserting after subparagraph (P) the following new subparagraph:

“(Q) section 6050Q(c) (relating to returns relating to certain purchases of fish),”.

(C) The table of sections for subpart B of part III of subchapter A of chapter 68 is amended by adding at the end the following new item:

“Sec. 6050Q. Returns relating to certain purchases of fish.”.

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to payments made after December 31, 1996.

## Subtitle B—Extension of Certain Expiring Provisions

**SEC. 1201. WORK OPPORTUNITY TAX CREDIT.**

(a) AMOUNT OF CREDIT.—Subsection (a) of section 51 (relating to amount of credit) is amended by striking “40 percent” and inserting “35 percent”.

(b) MEMBERS OF TARGETED GROUPS.—Subsection (d) of section 51 is amended to read as follows:

“(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—



“(1) IN GENERAL.—An individual is a member of a targeted group if such individual is—

- “(A) a qualified IV–A recipient,
- “(B) a qualified veteran,
- “(C) a qualified ex-felon,
- “(D) a high-risk youth,
- “(E) a vocational rehabilitation referral, or
- “(F) a qualified summer youth employee.

“(2) QUALIFIED IV–A RECIPIENT.—

“(A) IN GENERAL.—The term ‘qualified IV–A recipient’ means any individual who is certified by the designated local agency as being a member of a family receiving assistance under a IV–A program for at least a 9-month period ending during the 9-month period ending on the hiring date.

“(B) IV–A PROGRAM.—For purposes of this paragraph, the term ‘IV–A program’ means any program providing assistance under a State plan approved under part A of title IV of the Social Security Act (relating to assistance for needy families with minor children) and any successor of such program.

“(3) QUALIFIED VETERAN.—

“(A) IN GENERAL.—The term ‘qualified veteran’ means any veteran who is certified by the designated local agency as being—

“(i) a member of a family receiving assistance under a IV–A program (as defined in paragraph (2)(B)) for at least a 9-month period ending during the 12-month period ending on the hiring date, or

“(ii) a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.

“(B) VETERAN.—For purposes of subparagraph (A), the term ‘veteran’ means any individual who is certified by the designated local agency as—

“(i)(I) having served on active duty (other than active duty for training) in the Armed Forces of the United States for a period of more than 180 days, or

“(II) having been discharged or released from active duty in the Armed Forces of the United States for a service-connected disability, and

“(ii) not having any day during the 60-day period ending on the hiring date which was a day of extended active duty in the Armed Forces of the United States.

For purposes of clause (ii), the term ‘extended active duty’ means a period of more than 90 days during which the individual was on active duty (other than active duty for training).

“(4) QUALIFIED EX-FELON.—The term ‘qualified ex-felon’ means any individual who is certified by the designated local agency—

“(A) as having been convicted of a felony under any statute of the United States or any State,

“(B) as having a hiring date which is not more than 1 year after the last date on which such individual was so convicted or was released from prison, and

“(C) as being a member of a family which had an income during the 6 months immediately preceding the earlier of the month in which such income determination occurs or the month in which the hiring date occurs, which, on an annual basis, would be 70 percent or less of the Bureau of Labor Statistics lower living standard.

Any determination under subparagraph (C) shall be valid for the 45-day period beginning on the date such determination is made.

“(5) HIGH-RISK YOUTH.—

“(A) IN GENERAL.—The term ‘high-risk youth’ means any individual who is certified by the designated local agency—

“(i) as having attained age 18 but not age 25 on the hiring date, and

“(ii) as having his principal place of abode within an empowerment zone or enterprise community.

“(B) YOUTH MUST CONTINUE TO RESIDE IN ZONE.—In the case of a high-risk youth, the term ‘qualified wages’ shall not include wages paid or incurred for services performed while such youth’s principal place of abode is outside an empowerment zone or enterprise community.

“(6) VOCATIONAL REHABILITATION REFERRAL.—The term ‘vocational rehabilitation referral’ means any individual who is certified by the designated local agency as—

“(A) having a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

“(B) having been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to—

“(i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or

“(ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code.

“(7) QUALIFIED SUMMER YOUTH EMPLOYEE.—

“(A) IN GENERAL.—The term ‘qualified summer youth employee’ means any individual—

“(i) who performs services for the employer between May 1 and September 15,

“(ii) who is certified by the designated local agency as having attained age 16 but not 18 on the hiring date (or if later, on May 1 of the calendar year involved),

“(iii) who has not been an employee of the employer during any period prior to the 90-day period described in subparagraph (B)(i), and

“(iv) who is certified by the designated local agency as having his principal place of abode within an empowerment zone or enterprise community.

“(B) SPECIAL RULES FOR DETERMINING AMOUNT OF CREDIT.—For purposes of applying this subpart to wages paid or incurred to any qualified summer youth employee—

“(i) subsection (b)(2) shall be applied by substituting ‘any 90-day period between May 1 and September 15’ for ‘the 1-year period beginning with the day the individual begins work for the employer’, and

“(ii) subsection (b)(3) shall be applied by substituting ‘\$3,000’ for ‘\$6,000’.

The preceding sentence shall not apply to an individual who, with respect to the same employer, is certified as a member of another targeted group after such individual has been a qualified summer youth employee.

“(C) YOUTH MUST CONTINUE TO RESIDE IN ZONE.—Paragraph (5)(B) shall apply for purposes of this paragraph.

“(8) HIRING DATE.—The term ‘hiring date’ means the day the individual is hired by the employer.

“(9) DESIGNATED LOCAL AGENCY.—The term ‘designated local agency’ means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49-49n).

“(10) SPECIAL RULES FOR CERTIFICATIONS.—

“(A) IN GENERAL.—An individual shall not be treated as a member of a targeted group unless—

“(i) on or before the day on which such individual begins work for the employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group, or

“(ii)(I) on or before the day the individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and

“(II) not later than the 14th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for such a certification from such agency.

For purposes of this paragraph, the term ‘pre-screening notice’ means a document (in such form as the Secretary shall prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

“(B) INCORRECT CERTIFICATIONS.—If—

“(i) an individual has been certified by a designated local agency as a member of a targeted group, and

“(ii) such certification is incorrect because it was based on false information provided by such individual,

the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages.

“(C) EXPLANATION OF DENIAL OF REQUEST.—If a designated local agency denies a request for certification of membership in a targeted group, such

agency shall provide to the person making such request a written explanation of the reasons for such denial.”

(c) **MINIMUM EMPLOYMENT PERIOD.**—Paragraph (3) of section 51(i) (relating to certain individuals ineligible) is amended to read as follows:

“(3) **INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.**—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

“(A) is employed by the employer at least 180 days (20 days in the case of a qualified summer youth employee), or

“(B) has completed at least 500 hours (120 hours in the case of a qualified summer youth employee) of services performed for the employer.”

(d) **TERMINATION.**—Paragraph (4) of section 51(c) (relating to wages defined) is amended to read as follows:

“(4) **TERMINATION.**—The term ‘wages’ shall not include any amount paid or incurred to an individual who begins work for the employer—

“(A) after December 31, 1994, and before July 1, 1996, or

“(B) after June 30, 1997.”

(e) **REDESIGNATION OF CREDIT.**—

(1) Sections 38(b)(2) and 51(a) are each amended by striking “targeted jobs credit” and inserting “work opportunity credit”.

(2) The subpart heading for subpart F of part IV of subchapter A of chapter 1 is amended by striking “**Targeted Jobs Credit**” and inserting “**Work Opportunity Credit**”.

(3) The table of subparts for such part IV is amended by striking “targeted jobs credit” and inserting “work opportunity credit”.

(4) The heading for paragraph (3) of section 1396(c) is amended by striking “**TARGETED JOBS CREDIT**” and inserting “**WORK OPPORTUNITY CREDIT**”.

(f) **TECHNICAL AMENDMENT.**—Paragraph (1) of section 51(c) is amended by striking “, subsection (d)(8)(D),”.

(g) **EFFECTIVE DATE.**—The amendments made by this section shall apply to individuals who begin work for the employer after June 30, 1996.

#### **SEC. 1202. EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE PROGRAMS.**

(a) **EXTENSION.**—Subsection (d) of section 127 (relating to educational assistance programs) is amended by striking “December 31, 1994” and inserting “December 31, 1996”.

(b) **LIMITATION TO EDUCATION BELOW GRADUATE LEVEL.**—The last sentence of section 127(c)(1) is amended by inserting before the period “or at the graduate level”.

(c) **EFFECTIVE DATES.**—

(1) **EXTENSION.**—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1994.

(2) **LIMITATION.**—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1995.

(3) **EXPEDITED PROCEDURES.**—The Secretary of the Treasury shall establish expedited procedures for the refund of any overpayment of taxes imposed by chapter 24 of the Internal Revenue Code of 1986 which is attributable to amounts excluded from gross income during 1995 or 1996 under section 127 of such Code, including procedures waiving the requirement that an employer obtain an employee’s signature where the employer demonstrates to the satisfaction of the Secretary that any refund collected by the employer on behalf of the employee will be paid to the employee.

#### **SEC. 1203. FUTA EXEMPTION FOR ALIEN AGRICULTURAL WORKERS.**

(a) **IN GENERAL.**—Subparagraph (B) of section 3306(c)(1) (defining employment) is amended by striking “before January 1, 1995,”.

(b) **EFFECTIVE DATE.**—The amendment made by subsection (a) shall apply to services performed after December 31, 1994.

## **Subtitle C—Provisions Relating to S Corporations**

#### **SEC. 1301. S CORPORATIONS PERMITTED TO HAVE 75 SHAREHOLDERS.**

Subparagraph (A) of section 1361(b)(1) (defining small business corporation) is amended by striking “35 shareholders” and inserting “75 shareholders”.

**SEC. 1302. ELECTING SMALL BUSINESS TRUSTS.**

(a) **GENERAL RULE.**—Subparagraph (A) of section 1361(c)(2) (relating to certain trusts permitted as shareholders) is amended by inserting after clause (iv) the following new clause:

“(v) An electing small business trust.”

(b) **CURRENT BENEFICIARIES TREATED AS SHAREHOLDERS.**—Subparagraph (B) of section 1361(c)(2) is amended by adding at the end the following new clause:

“(v) In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period.”

(c) **ELECTING SMALL BUSINESS TRUST DEFINED.**—Section 1361 (defining S corporation) is amended by adding at the end the following new subsection:

“(e) **ELECTING SMALL BUSINESS TRUST DEFINED.**—

“(1) **ELECTING SMALL BUSINESS TRUST.**—For purposes of this section—

“(A) **IN GENERAL.**—Except as provided in subparagraph (B), the term ‘electing small business trust’ means any trust if—

“(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c) which holds a contingent interest and is not a potential current beneficiary,

“(ii) no interest in such trust was acquired by purchase, and

“(iii) an election under this subsection applies to such trust.

“(B) **CERTAIN TRUSTS NOT ELIGIBLE.**—The term ‘electing small business trust’ shall not include—

“(i) any qualified subchapter S trust (as defined in subsection (d)(3)) if an election under subsection (d)(2) applies to any corporation the stock of which is held by such trust, and

“(ii) any trust exempt from tax under this subtitle.

“(C) **PURCHASE.**—For purposes of subparagraph (A), the term ‘purchase’ means any acquisition if the basis of the property acquired is determined under section 1012.

“(2) **POTENTIAL CURRENT BENEFICIARY.**—For purposes of this section, the term ‘potential current beneficiary’ means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust. If a trust disposes of all of the stock which it holds in an S corporation, then, with respect to such corporation, the term ‘potential current beneficiary’ does not include any person who first met the requirements of the preceding sentence during the 60-day period ending on the date of such disposition.

“(3) **ELECTION.**—An election under this subsection shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

“(4) **CROSS REFERENCE.**—

“**For special treatment of electing small business trusts, see section 641(d).**”

(d) **TAXATION OF ELECTING SMALL BUSINESS TRUSTS.**—Section 641 (relating to imposition of tax on trusts) is amended by adding at the end the following new subsection:

“(d) **SPECIAL RULES FOR TAXATION OF ELECTING SMALL BUSINESS TRUSTS.**—

“(1) **IN GENERAL.**—For purposes of this chapter—

“(A) the portion of any electing small business trust which consists of stock in 1 or more S corporations shall be treated as a separate trust, and

“(B) the amount of the tax imposed by this chapter on such separate trust shall be determined with the modifications of paragraph (2).

“(2) **MODIFICATIONS.**—For purposes of paragraph (1), the modifications of this paragraph are the following:

“(A) Except as provided in section 1(h), the amount of the tax imposed by section 1(e) shall be determined by using the highest rate of tax set forth in section 1(e).

“(B) The exemption amount under section 55(d) shall be zero.

“(C) The only items of income, loss, deduction, or credit to be taken into account are the following:

“(i) The items required to be taken into account under section 1366.

“(ii) Any gain or loss from the disposition of stock in an S corporation.

“(iii) To the extent provided in regulations, State or local income taxes or administrative expenses to the extent allocable to items described in clauses (i) and (ii).

No deduction or credit shall be allowed for any amount not described in this paragraph, and no item described in this paragraph shall be apportioned to any beneficiary.

“(D) No amount shall be allowed under paragraph (1) or (2) of section 1211(b).

“(3) TREATMENT OF REMAINDER OF TRUST AND DISTRIBUTIONS.—For purposes of determining—

“(A) the amount of the tax imposed by this chapter on the portion of any electing small business trust not treated as a separate trust under paragraph (1), and

“(B) the distributable net income of the entire trust, the items referred to in paragraph (2)(C) shall be excluded. Except as provided in the preceding sentence, this subsection shall not affect the taxation of any distribution from the trust.

“(4) TREATMENT OF UNUSED DEDUCTIONS WHERE TERMINATION OF SEPARATE TRUST.—If a portion of an electing small business trust ceases to be treated as a separate trust under paragraph (1), any carryover or excess deduction of the separate trust which is referred to in section 642(h) shall be taken into account by the entire trust.

“(5) ELECTING SMALL BUSINESS TRUST.—For purposes of this subsection, the term ‘electing small business trust’ has the meaning given such term by section 1361(e)(1).”

(e) TECHNICAL AMENDMENT.—Paragraph (1) of section 1366(a) is amended by inserting “, or of a trust or estate which terminates,” after “who dies”.

#### SEC. 1303. EXPANSION OF POST-DEATH QUALIFICATION FOR CERTAIN TRUSTS.

Subparagraph (A) of section 1361(c)(2) (relating to certain trusts permitted as shareholders) is amended—

- (1) by striking “60-day period” each place it appears in clauses (ii) and (iii) and inserting “2-year period”, and
- (2) by striking the last sentence in clause (ii).

#### SEC. 1304. FINANCIAL INSTITUTIONS PERMITTED TO HOLD SAFE HARBOR DEBT.

Clause (iii) of section 1361(c)(5)(B) (defining straight debt) is amended by striking “or a trust described in paragraph (2)” and inserting “a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money”.

#### SEC. 1305. RULES RELATING TO INADVERTENT TERMINATIONS AND INVALID ELECTIONS.

(a) GENERAL RULE.—Subsection (f) of section 1362 (relating to inadvertent terminations) is amended to read as follows:

“(f) INADVERTENT INVALID ELECTIONS OR TERMINATIONS.—If—

“(1) an election under subsection (a) by any corporation—

“(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or

“(B) was terminated under paragraph (2) or (3) of subsection (d),

“(2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent,

“(3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken—

“(A) so that the corporation is a small business corporation, or

“(B) to acquire the required shareholder consents, and

“(4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.”

(b) LATE ELECTIONS, ETC.—Subsection (b) of section 1362 is amended by adding at the end the following new paragraph:

“(5) AUTHORITY TO TREAT LATE ELECTIONS, ETC., AS TIMELY.—If—

“(A) an election under subsection (a) is made for any taxable year (determined without regard to paragraph (3)) after the date prescribed by this

subsection for making such election for such taxable year or no such election is made for any taxable year, and

“(B) the Secretary determines that there was reasonable cause for the failure to timely make such election, the Secretary may treat such an election as timely made for such taxable year (and paragraph (3) shall not apply).”

(c) EFFECTIVE DATE.—The amendments made by subsection (a) and (b) shall apply with respect to elections for taxable years beginning after December 31, 1982.

#### SEC. 1306. AGREEMENT TO TERMINATE YEAR.

Paragraph (2) of section 1377(a) (relating to pro rata share) is amended to read as follows:

“(2) ELECTION TO TERMINATE YEAR.—

“(A) IN GENERAL.—Under regulations prescribed by the Secretary, if any shareholder terminates the shareholder’s interest in the corporation during the taxable year and all affected shareholders and the corporation agree to the application of this paragraph, paragraph (1) shall be applied to the affected shareholders as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.

“(B) AFFECTED SHAREHOLDERS.—For purposes of subparagraph (A), the term ‘affected shareholders’ means the shareholder whose interest is terminated and all shareholders to whom such shareholder has transferred shares during the taxable year. If such shareholder has transferred shares to the corporation, the term ‘affected shareholders’ shall include all persons who are shareholders during the taxable year.”

#### SEC. 1307. EXPANSION OF POST-TERMINATION TRANSITION PERIOD.

(a) IN GENERAL.—Paragraph (1) of section 1377(b) (relating to post-termination transition period) is amended by striking “and” at the end of subparagraph (A), by redesignating subparagraph (B) as subparagraph (C), and by inserting after subparagraph (A) the following new subparagraph:

“(B) the 120-day period beginning on the date of any determination pursuant to an audit of the taxpayer which follows the termination of the corporation’s election and which adjusts a subchapter S item of income, loss, or deduction of the corporation arising during the S period (as defined in section 1368(e)(2)), and”.

(b) DETERMINATION DEFINED.—Paragraph (2) of section 1377(b) is amended by striking subparagraphs (A) and (B), by redesignating subparagraph (C) as subparagraph (B), and by inserting before subparagraph (B) (as so redesignated) the following new subparagraph:

“(A) a determination as defined in section 1313(a), or”.

(c) REPEAL OF SPECIAL AUDIT PROVISIONS FOR SUBCHAPTER S ITEMS.—

(1) GENERAL RULE.—Subchapter D of chapter 63 (relating to tax treatment of subchapter S items) is hereby repealed.

(2) CONSISTENT TREATMENT REQUIRED.—Section 6037 (relating to return of S corporation) is amended by adding at the end the following new subsection:

“(c) SHAREHOLDER’S RETURN MUST BE CONSISTENT WITH CORPORATE RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—

“(1) IN GENERAL.—A shareholder of an S corporation shall, on such shareholder’s return, treat a subchapter S item in a manner which is consistent with the treatment of such item on the corporate return.

“(2) NOTIFICATION OF INCONSISTENT TREATMENT.—

“(A) IN GENERAL.—In the case of any subchapter S item, if—

“(i) the corporation has filed a return but the shareholder’s treatment on his return is (or may be) inconsistent with the treatment of the item on the corporate return, or

“(ii) the corporation has not filed a return, and

“(ii) the shareholder files with the Secretary a statement identifying the inconsistency, paragraph (1) shall not apply to such item.

“(B) SHAREHOLDER RECEIVING INCORRECT INFORMATION.—A shareholder shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a subchapter S item if the shareholder—

“(i) demonstrates to the satisfaction of the Secretary that the treatment of the subchapter S item on the shareholder’s return is consistent with the treatment of the item on the schedule furnished to the shareholder by the corporation, and

“(ii) elects to have this paragraph apply with respect to that item.

“(3) EFFECT OF FAILURE TO NOTIFY.—In any case—

“(A) described in subparagraph (A)(i)(I) of paragraph (2), and  
 “(B) in which the shareholder does not comply with subparagraph (A)(ii) of paragraph (2),

any adjustment required to make the treatment of the items by such shareholder consistent with the treatment of the items on the corporate return shall be treated as arising out of mathematical or clerical errors and assessed according to section 6213(b)(1). Paragraph (2) of section 6213(b) shall not apply to any assessment referred to in the preceding sentence.

“(4) SUBCHAPTER S ITEM.—For purposes of this subsection, the term ‘subchapter S item’ means any item of an S corporation to the extent that regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the corporation level than at the shareholder level.

“(5) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—

“For addition to tax in the case of a shareholder’s negligence in connection with, or disregard of, the requirements of this section, see part II of subchapter A of chapter 68.”

(3) CONFORMING AMENDMENTS.—

(A) Section 1366 is amended by striking subsection (g).

(B) Subsection (b) of section 6233 is amended to read as follows:

“(b) SIMILAR RULES IN CERTAIN CASES.—If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.”

(C) The table of subchapters for chapter 63 is amended by striking the item relating to subchapter D.

#### SEC. 1308. S CORPORATIONS PERMITTED TO HOLD SUBSIDIARIES.

(a) IN GENERAL.—Paragraph (2) of section 1361(b) (defining ineligible corporation) is amended by striking subparagraph (A) and by redesignating subparagraphs (B), (C), (D), and (E) as subparagraphs (A), (B), (C), and (D), respectively.

(b) TREATMENT OF CERTAIN WHOLLY OWNED S CORPORATION SUBSIDIARIES.—Section 1361(b) (defining small business corporation) is amended by adding at the end the following new paragraph:

“(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

“(A) IN GENERAL.—For purposes of this title—

“(i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

“(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

“(B) QUALIFIED SUBCHAPTER S SUBSIDIARY.—For purposes of this paragraph, the term ‘qualified subchapter S subsidiary’ means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if—

“(i) 100 percent of the stock of such corporation is held by the S corporation, and

“(ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

“(C) TREATMENT OF TERMINATIONS OF QUALIFIED SUBCHAPTER S SUBSIDIARY STATUS.—For purposes of this title, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of subparagraph (B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.”

(c) CERTAIN DIVIDENDS NOT TREATED AS PASSIVE INVESTMENT INCOME.—Paragraph (3) of section 1362(d) is amended by adding at the end the following new subparagraph:

“(F) TREATMENT OF CERTAIN DIVIDENDS.—If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term ‘passive investment income’ shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business.”

(d) CONFORMING AMENDMENTS.—

(1) Subsection (c) of section 1361 is amended by striking paragraph (6).

(2) Subsection (b) of section 1504 (defining includible corporation) is amended by adding at the end the following new paragraph:

“(8) An S corporation.”

**SEC. 1309. TREATMENT OF DISTRIBUTIONS DURING LOSS YEARS.**(a) **ADJUSTMENTS FOR DISTRIBUTIONS TAKEN INTO ACCOUNT BEFORE LOSSES.**—

(1) Subparagraph (A) of section 1366(d)(1) (relating to losses and deductions cannot exceed shareholder's basis in stock and debt) is amended by striking “paragraph (1)” and inserting “paragraphs (1) and (2)(A)”.

(2) Subsection (d) of section 1368 (relating to certain adjustments taken into account) is amended by adding at the end the following new sentence:  
“In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year.”(b) **ACCUMULATED ADJUSTMENTS ACCOUNT.**—Paragraph (1) of section 1368(e) (relating to accumulated adjustments account) is amended by adding at the end the following new subparagraph:“(C) **NET LOSS FOR YEAR DISREGARDED.**—“(i) **IN GENERAL.**—In applying this section to distributions made during any taxable year, the amount in the accumulated adjustments account as of the close of such taxable year shall be determined without regard to any net negative adjustment for such taxable year.“(ii) **NET NEGATIVE ADJUSTMENT.**—For purposes of clause (i), the term ‘net negative adjustment’ means, with respect to any taxable year, the excess (if any) of—

“(I) the reductions in the account for the taxable year (other than for distributions), over

“(II) the increases in such account for such taxable year.”

(c) **CONFORMING AMENDMENTS.**—Subparagraph (A) of section 1368(e)(1) is amended—

(1) by striking “as provided in subparagraph (B)” and inserting “as otherwise provided in this paragraph”, and

(2) by striking “section 1367(b)(2)(A)” and inserting “section 1367(a)(2)”.

**SEC. 1310. TREATMENT OF S CORPORATIONS UNDER SUBCHAPTER C.**

Subsection (a) of section 1371 (relating to application of subchapter C rules) is amended to read as follows:

“(a) **APPLICATION OF SUBCHAPTER C RULES.**—Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.”**SEC. 1311. ELIMINATION OF CERTAIN EARNINGS AND PROFITS.**(a) **IN GENERAL.**—If—

(1) a corporation was an electing small business corporation under subchapter S of chapter 1 of the Internal Revenue Code of 1986 for any taxable year beginning before January 1, 1983, and

(2) such corporation is an S corporation under subchapter S of chapter 1 of such Code for its first taxable year beginning after December 31, 1996,  
the amount of such corporation's accumulated earnings and profits (as of the beginning of such first taxable year) shall be reduced by an amount equal to the portion (if any) of such accumulated earnings and profits which were accumulated in any taxable year beginning before January 1, 1983, for which such corporation was an electing small business corporation under such subchapter S.(b) **CONFORMING AMENDMENTS.**—

(1) Paragraph (3) of section 1362(d), as amended by section 1308, is amended—

(A) by striking “SUBCHAPTER C” in the paragraph heading and inserting “ACCUMULATED”,

(B) by striking “subchapter C” in subparagraph (A)(i)(I) and inserting “accumulated”, and

(C) by striking subparagraph (B) and redesignating the following subparagraphs accordingly.

(2)(A) Subsection (a) of section 1375 is amended by striking “subchapter C” in paragraph (1) and inserting “accumulated”.

(B) Paragraph (3) of section 1375(b) is amended to read as follows:

“(3) **PASSIVE INVESTMENT INCOME, ETC.**—The terms ‘passive investment income’ and ‘gross receipts’ have the same respective meanings as when used in paragraph (3) of section 1362(d).”

(C) The section heading for section 1375 is amended by striking “subchapter c” and inserting “accumulated”.

(D) The table of sections for part III of subchapter S of chapter 1 is amended by striking “subchapter C” in the item relating to section 1375 and inserting “accumulated”.



(3) Clause (i) of section 1042(c)(4)(A) is amended by striking “section 1362(d)(3)(D)” and inserting “section 1362(d)(3)(C)”.

**SEC. 1312. CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS UNDER AT-RISK RULES ALLOWED.**

Paragraph (3) of section 1366(d) (relating to carryover of disallowed losses and deductions to post-termination transition period) is amended by adding at the end the following new subparagraph:

“(D) AT-RISK LIMITATIONS.—To the extent that any increase in adjusted basis described in subparagraph (B) would have increased the shareholder’s amount at risk under section 465 if such increase had occurred on the day preceding the commencement of the post-termination transition period, rules similar to the rules described in subparagraphs (A) through (C) shall apply to any losses disallowed by reason of section 465(a).”

**SEC. 1313. ADJUSTMENTS TO BASIS OF INHERITED S STOCK TO REFLECT CERTAIN ITEMS OF INCOME.**

(a) IN GENERAL.—Subsection (b) of section 1367 (relating to adjustments to basis of stock of shareholders, etc.) is amended by adding at the end the following new paragraph:

“(4) ADJUSTMENTS IN CASE OF INHERITED STOCK.—

“(A) IN GENERAL.—If any person acquires stock in an S corporation by reason of the death of a decedent or by bequest, devise, or inheritance, section 691 shall be applied with respect to any item of income of the S corporation in the same manner as if the decedent had held directly his pro rata share of such item.

“(B) ADJUSTMENTS TO BASIS.—The basis determined under section 1014 of any stock in an S corporation shall be reduced by the portion of the value of the stock which is attributable to items constituting income in respect of the decedent.”

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply in the case of decedents dying after the date of the enactment of this Act.

**SEC. 1314. S CORPORATIONS ELIGIBLE FOR RULES APPLICABLE TO REAL PROPERTY SUBDIVIDED FOR SALE BY NONCORPORATE TAXPAYERS.**

(a) IN GENERAL.—Subsection (a) of section 1237 (relating to real property subdivided for sale) is amended by striking “other than a corporation” in the material preceding paragraph (1) and inserting “other than a C corporation”.

(b) CONFORMING AMENDMENT.—Subparagraph (A) of section 1237(a)(2) is amended by inserting “an S corporation which included the taxpayer as a shareholder,” after “controlled by the taxpayer.”

**SEC. 1315. EFFECTIVE DATE.**

(a) IN GENERAL.—Except as otherwise provided in this subtitle, the amendments made by this subtitle shall apply to taxable years beginning after December 31, 1996.

(b) TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW.—For purposes of section 1362(g) of the Internal Revenue Code of 1986 (relating to election after termination), any termination under section 1362(d) of such Code in a taxable year beginning before January 1, 1997, shall not be taken into account.

## Subtitle D—Pension Simplification

### CHAPTER 1—SIMPLIFIED DISTRIBUTION RULES

**SEC. 1401. REPEAL OF 5-YEAR INCOME AVERAGING FOR LUMP-SUM DISTRIBUTIONS.**

(a) IN GENERAL.—Subsection (d) of section 402 (relating to taxability of beneficiary of employees’ trust) is amended to read as follows:

“(d) TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).”

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (D) of section 402(e)(4) (relating to other rules applicable to exempt trusts) is amended to read as follows:

“(D) LUMP-SUM DISTRIBUTION.—For purposes of this paragraph—

“(i) IN GENERAL.—The term ‘lump sum distribution’ means the distribution or payment within one taxable year of the recipient of the bal-

ance to the credit of an employee which becomes payable to the recipient—

- “(I) on account of the employee’s death,
- “(II) after the employee attains age 59½,
- “(III) on account of the employee’s separation from service, or
- “(IV) after the employee has become disabled (within the meaning of section 72(m)(7)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

“(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

“(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

“(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

“(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

“(iv) AMOUNTS SUBJECT TO PENALTY.—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

“(v) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purposes of this paragraph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

“(vi) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

“(vii) LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee.”

(2) Section 402(c) (relating to rules applicable to rollovers from exempt trusts) is amended by striking paragraph (10).

(3) Paragraph (1) of section 55(c) (defining regular tax) is amended by striking “shall not include any tax imposed by section 402(d) and”.

(4) Paragraph (8) of section 62(a) (relating to certain portion of lump-sum distributions from pension plans taxed under section 402(d)) is hereby repealed.

(5) Section 401(a)(28)(B) (relating to coordination with distribution rules) is amended by striking clause (v).

(6) Subparagraph (B)(ii) of section 401(k)(10) (relating to distributions that must be lump-sum distributions) is amended to read as follows:

“(ii) LUMP-SUM DISTRIBUTION.—For purposes of this subparagraph, the term ‘lump-sum distribution’ has the meaning given such term by section 402(e)(4)(D) (without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof).”

(7) Section 406(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(8) Section 407(c) (relating to termination of status as deemed employee not to be treated as separation from service for purposes of limitation of tax) is hereby repealed.

(9) Section 691(c) (relating to deduction for estate tax) is amended by striking paragraph (5).

(10) Paragraph (1) of section 871(b) (relating to imposition of tax) is amended by striking “section 1, 55, or 402(d)(1)” and inserting “section 1 or 55”.

(11) Subsection (b) of section 877 (relating to alternative tax) is amended by striking “section 1, 55, or 402(d)(1)” and inserting “section 1 or 55”.

(12) Section 4980A(c)(4) is amended—

(A) by striking “to which an election under section 402(d)(4)(B) applies” and inserting “(as defined in section 402(e)(4)(D)) with respect to which the individual elects to have this paragraph apply”,

(B) by adding at the end the following new flush sentence:  
“An individual may elect to have this paragraph apply to only one lump-sum distribution.”, and

(C) by striking the heading and inserting:

“(4) SPECIAL ONE-TIME ELECTION.—”.

(13) Section 402(e) is amended by striking paragraph (5).

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

(2) RETENTION OF CERTAIN TRANSITION RULES.—Notwithstanding any other provision of this section, the amendments made by this section shall not apply to any distribution for which the taxpayer elects the benefits of section 1122 (h)(3) or (h)(5) of the Tax Reform Act of 1986. For purposes of the preceding sentence, the rules of sections 402(c)(10) and 402(d) of the Internal Revenue Code of 1986 (as in effect before the amendments made by this Act) shall apply.

#### SEC. 1402. REPEAL OF \$5,000 EXCLUSION OF EMPLOYEES’ DEATH BENEFITS.

(a) IN GENERAL.—Subsection (b) of section 101 is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Subsection (c) of section 101 is amended by striking “subsection (a) or (b)” and inserting “subsection (a)”.

(2) Sections 406(e) and 407(e) are each amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(3) Section 7701(a)(20) is amended by striking “, for the purpose of applying the provisions of section 101(b) with respect to employees’ death benefits”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to decedents dying after the date of the enactment of this Act.

#### SEC. 1403. SIMPLIFIED METHOD FOR TAXING ANNUITY DISTRIBUTIONS UNDER CERTAIN EMPLOYER PLANS.

(a) GENERAL RULE.—Subsection (d) of section 72 (relating to annuities; certain proceeds of endowment and life insurance contracts) is amended to read as follows:

“(d) SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.—

“(1) SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.—

“(A) IN GENERAL.—In the case of any amount received as an annuity under a qualified employer retirement plan—

“(i) subsection (b) shall not apply, and

“(ii) the investment in the contract shall be recovered as provided in this paragraph.

“(B) METHOD OF RECOVERING INVESTMENT IN CONTRACT.—

“(i) IN GENERAL.—Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

“(I) the investment in the contract (as of the annuity starting date), by

“(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).

“(ii) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph.

“(iii) NUMBER OF ANTICIPATED PAYMENTS.—

<b>"If the age of the primary annuitant on the annuity starting date is:</b>	<b>The number of anticipated payments is:</b>
Not more than 55 .....	360
More than 55 but not more than 60 .....	310
More than 60 but not more than 65 .....	260
More than 65 but not more than 70 .....	210
More than 70 .....	160.

"(C) ADJUSTMENT FOR REFUND FEATURE NOT APPLICABLE.—For purposes of this paragraph, investment in the contract shall be determined under subsection (c)(1) without regard to subsection (c)(2).

"(D) SPECIAL RULE WHERE LUMP SUM PAID IN CONNECTION WITH COMMENCEMENT OF ANNUITY PAYMENTS.—If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

"(i) such payment shall be taxable under subsection (e) as if received before the annuity starting date, and

"(ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

"(E) EXCEPTION.—This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

"(F) ADJUSTMENT WHERE ANNUITY PAYMENTS NOT ON MONTHLY BASIS.—In any case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to take into account the period on the basis of which such payments are made.

"(G) QUALIFIED EMPLOYER RETIREMENT PLAN.—For purposes of this paragraph, the term 'qualified employer retirement plan' means any plan or contract described in paragraph (1), (2), or (3) of section 4974(c).

"(2) TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS.—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply in cases where the annuity starting date is after the 90th day after the date of the enactment of this Act.

#### **SEC. 1404. REQUIRED DISTRIBUTIONS.**

(a) IN GENERAL.—Section 401(a)(9)(C) (defining required beginning date) is amended to read as follows:

"(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'required beginning date' means April 1 of the calendar year following the later of—

"(I) the calendar year in which the employee attains age 70½,  
or

"(II) the calendar year in which the employee retires.

"(ii) EXCEPTION.—Subclause (II) of clause (i) shall not apply—

"(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, or

"(II) for purposes of section 408 (a)(6) or (b)(3).

"(iii) ACTUARIAL ADJUSTMENT.—In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

"(iv) EXCEPTION FOR GOVERNMENTAL AND CHURCH PLANS.—Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term 'church plan' means a plan maintained by a church for church employees, and the term 'church' means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1996.

## CHAPTER 2—INCREASED ACCESS TO PENSION PLANS

### Subchapter A—Simple Savings Plans

#### SEC. 1421. ESTABLISHMENT OF SAVINGS INCENTIVE MATCH PLANS FOR EMPLOYEES OF SMALL EMPLOYERS.

(a) IN GENERAL.—Section 408 (relating to individual retirement accounts) is amended by redesignating subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

“(p) SIMPLE RETIREMENT ACCOUNTS.—

“(1) IN GENERAL.—For purposes of this title, the term ‘simple retirement account’ means an individual retirement plan (as defined in section 7701(a)(37))—

“(A) with respect to which the requirements of paragraphs (3), (4), and (5) are met; and

“(B) with respect to which the only contributions allowed are contributions under a qualified salary reduction arrangement.

“(2) QUALIFIED SALARY REDUCTION ARRANGEMENT.—

“(A) IN GENERAL.—For purposes of this subsection, the term ‘qualified salary reduction arrangement’ means a written arrangement of an eligible employer under which—

“(i) an employee eligible to participate in the arrangement may elect to have the employer make payments—

“(I) as elective employer contributions to a simple retirement account on behalf of the employee, or

“(II) to the employee directly in cash,

“(ii) the amount which an employee may elect under clause (i) for any year is required to be expressed as a percentage of compensation and may not exceed a total of \$6,000 for any year,

“(iii) the employer is required to make a matching contribution to the simple retirement account for any year in an amount equal to so much of the amount the employee elects under clause (i)(I) as does not exceed the applicable percentage of compensation for the year, and

“(iv) no contributions may be made other than contributions described in clause (i) or (iii).

“(B) EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.—An employer shall be treated as meeting the requirements of subparagraph (A)(iii) for any year if, in lieu of the contributions described in such clause, the employer elects to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least \$5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 30-day period for such year under paragraph (5)(C).

“(C) DEFINITIONS.—For purposes of this subsection—

“(i) ELIGIBLE EMPLOYER.—The term ‘eligible employer’ means an employer who employs 100 or fewer employees on any day during the year.

“(ii) APPLICABLE PERCENTAGE.—

“(I) IN GENERAL.—The term ‘applicable percentage’ means 3 percent.

“(II) ELECTION OF LOWER PERCENTAGE.—An employer may elect to apply a lower percentage (not less than 1 percent) for any year for all employees eligible to participate in the plan for such year if the employer notifies the employees of such lower percentage within a reasonable period of time before the 30-day election period for such year under paragraph (5)(C). An employer may not elect a lower percentage under this subclause for any year if that election would result in the applicable percentage being lower than 3 percent in more than 2 of the years in the 5-year period ending with such year.

“(III) SPECIAL RULE FOR YEARS ARRANGEMENT NOT IN EFFECT.—If any year in the 5-year period described in subclause (II) is a year prior to the first year for which any qualified salary reduction arrangement is in effect with respect to the employer (or any predecessor), the employer shall be treated as if the level of the employer matching contribution was at 3 percent of compensation for such prior year.

“(D) ARRANGEMENT MAY BE ONLY PLAN OF EMPLOYER.—

“(i) IN GENERAL.—An arrangement shall not be treated as a qualified salary reduction arrangement for any year if the employer (or any predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, for service in any year in the period beginning with the year such arrangement became effective and ending with the year for which the determination is being made.

“(ii) QUALIFIED PLAN.—For purposes of this subparagraph, the term ‘qualified plan’ means a plan, contract, pension, or trust described in subparagraph (A) or (B) of section 219(g)(5).

“(E) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the \$6,000 amount under subparagraph (A)(ii) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter ending September 30, 1995, and any increase under this subparagraph which is not a multiple of \$500 shall be rounded to the next lower multiple of \$500.

“(3) VESTING REQUIREMENTS.—The requirements of this paragraph are met with respect to a simple retirement account if the employee’s rights to any contribution to the simple retirement account are nonforfeitable. For purposes of this paragraph, rules similar to the rules of subsection (k)(4) shall apply.

“(4) PARTICIPATION REQUIREMENTS.—

“(A) IN GENERAL.—The requirements of this paragraph are met with respect to any simple retirement account for a year only if, under the qualified salary reduction arrangement, all employees of the employer who—

“(i) received at least \$5,000 in compensation from the employer during any 2 preceding years, and

“(ii) are reasonably expected to receive at least \$5,000 in compensation during the year,

are eligible to make the election under paragraph (2)(A)(i) or receive the nonelective contribution described in paragraph (2)(B).

“(B) EXCLUDABLE EMPLOYEES.—An employer may elect to exclude from the requirement under subparagraph (A) employees described in section 410(b)(3).

“(5) ADMINISTRATIVE REQUIREMENTS.—The requirements of this paragraph are met with respect to any simplified retirement account if, under the qualified salary reduction arrangement—

“(A) an employer must—

“(i) make the elective employer contributions under paragraph (2)(A)(i) not later than the close of the 30-day period following the last day of the month with respect to which the contributions are to be made, and

“(ii) make the matching contributions under paragraph (2)(A)(iii) or the nonelective contributions under paragraph (2)(B) not later than the date described in section 404(m)(2)(B),

“(B) an employee may elect to terminate participation in such arrangement at any time during the year, except that if an employee so terminates, the arrangement may provide that the employee may not elect to resume participation until the beginning of the next year, and

“(C) each employee eligible to participate may elect, during the 30-day period before the beginning of any year (and the 30-day period before the first day such employee is eligible to participate), to participate in the arrangement, or to modify the amounts subject to such arrangement, for such year.

“(6) DEFINITIONS.—For purposes of this subsection—

“(A) COMPENSATION.—

“(i) IN GENERAL.—The term ‘compensation’ means amounts described in paragraphs (3) and (8) of section 6051(a).

“(ii) SELF-EMPLOYED.—In the case of an employee described in subparagraph (B), the term ‘compensation’ means net earnings from self-employment determined under section 1402(a) without regard to any contribution under this subsection.

“(B) EMPLOYEE.—The term ‘employee’ includes an employee as defined in section 401(c)(1).

“(C) YEAR.—The term ‘year’ means the calendar year.”

(b) TAX TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.—

(1) DEDUCTIBILITY OF CONTRIBUTIONS BY EMPLOYEES.—

(A) Section 219(b) (relating to maximum amount of deduction) is amended by adding at the end the following new paragraph:

“(4) SPECIAL RULE FOR SIMPLE RETIREMENT ACCOUNTS.—This section shall not apply with respect to any amount contributed to a simple retirement account established under section 408(p).”

(B) Section 219(g)(5)(A) (defining active participant) is amended by striking “or” at the end of clause (iv) and by adding at the end the following new clause:

“(vi) any simple retirement account (within the meaning of section 408(p)), or”.

(2) DEDUCTIBILITY OF EMPLOYER CONTRIBUTIONS.—Section 404 (relating to deductions for contributions of an employer to pension, etc. plans) is amended by adding at the end the following new subsection:

“(m) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—

“(1) IN GENERAL.—Employer contributions to a simple retirement account shall be treated as if they are made to a plan subject to the requirements of this section.

“(2) TIMING.—

“(A) DEDUCTION.—Contributions described in paragraph (1) shall be deductible in the taxable year of the employer with or within which the calendar year for which the contributions were made ends.

“(B) CONTRIBUTIONS AFTER END OF YEAR.—For purposes of this subsection, contributions shall be treated as made for a taxable year if they are made on account of the taxable year and are made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof).”

(3) CONTRIBUTIONS AND DISTRIBUTIONS.—

(A) Section 402 (relating to taxability of beneficiary of employees’ trust) is amended by adding at the end the following new subsection:

“(k) TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.—Rules similar to the rules of paragraphs (1) and (3) of subsection (h) shall apply to contributions and distributions with respect to a simple retirement account under section 408(p).”

(B) Section 408(d)(3) is amended by adding at the end the following new subparagraph:

“(G) SIMPLE RETIREMENT ACCOUNTS.—This paragraph shall not apply to any amount paid or distributed out of a simple retirement account (as defined in section 408(p)) unless—

“(i) it is paid into another simple retirement account, or

“(ii) in the case of any payment or distribution to which section 72(t)(8) does not apply, it is paid into an individual retirement plan.”

(C) Clause (i) of section 457(c)(2)(B) is amended by striking “section 402(h)(1)(B)” and inserting “section 402(h)(1)(B) or (k)”.

(4) PENALTIES.—

(A) EARLY WITHDRAWALS.—Section 72(t) (relating to additional tax in early distributions), as amended by this Act, is amended by adding at the end the following new paragraph:

“(6) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—In the case of any amount received from a simple retirement account (within the meaning of section 408(p)) during the 2-year period beginning on the date such individual first participated in any qualified salary reduction arrangement maintained by the individual’s employer under section 408(p)(2), paragraph (1) shall be applied by substituting ‘25 percent’ for ‘10 percent’.”

(B) FAILURE TO REPORT.—Section 6693 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) PENALTIES RELATING TO SIMPLE RETIREMENT ACCOUNTS.—

“(1) EMPLOYER PENALTIES.—An employer who fails to provide 1 or more notices required by section 408(l)(2)(C) shall pay a penalty of \$50 for each day on which such failures continue.

“(2) TRUSTEE PENALTIES.—A trustee who fails—

“(A) to provide 1 or more statements required by the last sentence of section 408(i) shall pay a penalty of \$50 for each day on which such failures continue, or

“(B) to provide 1 or more summary descriptions required by section 408(l)(2)(B) shall pay a penalty of \$50 for each day on which such failures continue.

“(3) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under this subsection with respect to any failure which the taxpayer shows was due to reasonable cause.”

(5) REPORTING REQUIREMENTS.—

(A) Section 408(l) is amended by adding at the end the following new paragraph:

“(2) SIMPLE RETIREMENT ACCOUNTS.—

“(A) NO EMPLOYER REPORTS.—Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a qualified salary reduction arrangement under subsection (p).

“(B) SUMMARY DESCRIPTION.—The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) shall provide to the employer maintaining the arrangement, each year a description containing the following information:

“(i) The name and address of the employer and the trustee.

“(ii) The requirements for eligibility for participation.

“(iii) The benefits provided with respect to the arrangement.

“(iv) The time and method of making elections with respect to the arrangement.

“(v) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

“(C) EMPLOYEE NOTIFICATION.—The employer shall notify each employee immediately before the period for which an election described in subsection (p)(5)(C) may be made of the employee’s opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B).”

(B) Section 408(l) is amended by striking “An employer” and inserting the following:

“(1) IN GENERAL.—An employer”.

(6) REPORTING REQUIREMENTS.—Section 408(i) is amended by adding at the end the following new flush sentence:

“In the case of a simple retirement account under subsection (p), only one report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within 30 days after each calendar year, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar year.”

(7) EXEMPTION FROM TOP-HEAVY PLAN RULES.—Section 416(g)(4) (relating to special rules for top-heavy plans) is amended by adding at the end the following new subparagraph:

“(G) SIMPLE RETIREMENT ACCOUNTS.—The term ‘top-heavy plan’ shall not include a simple retirement account under section 408(p).”

(8) EMPLOYMENT TAXES.—

(A) Paragraph (5) of section 3121(a) is amended by striking “or” at the end of subparagraph (F), by inserting “or” at the end of subparagraph (G), and by adding at the end the following new subparagraph:

“(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof.”

(B) Section 209(a)(4) of the Social Security Act is amended by inserting “, or (J) under an arrangement to which section 408(p) of such Code applies, other than any elective contributions under paragraph (2)(A)(i) thereof” before the semicolon at the end thereof.

(C) Paragraph (5) of section 3306(b) is amended by striking “or” at the end of subparagraph (F), by inserting “or” at the end of subparagraph (G), and by adding at the end the following new subparagraph:

“(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof.”

(D) Paragraph (12) of section 3401(a) is amended by adding the following new subparagraph:

“(D) under an arrangement to which section 408(p) applies; or”.

(9) CONFORMING AMENDMENTS.—

(A) Section 280G(b)(6) is amended by striking “or” at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting “, or” and by adding after subparagraph (C) the following new subparagraph:

“(D) a simple retirement account described in section 408(p).”

(B) Section 402(g)(3) is amended by striking “and” at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting “, and”, and by adding after subparagraph (C) the following new subparagraph:

“(D) any elective employer contribution under section 408(p)(2)(A)(i).”



(C) Subsections (b), (c), (m)(4)(B), and (n)(3)(B) of section 414 are each amended by inserting “408(p),” after “408(k),”.

(D) Section 4972(d)(1)(A) is amended by striking “and” at the end of clause (ii), by striking the period at the end of clause (iii) and inserting “, and”, and by adding after clause (iii) the following new clause:

“(iv) any simple retirement account (within the meaning of section 408(p)).”

(c) REPEAL OF SALARY REDUCTION SIMPLIFIED EMPLOYEE PENSIONS.—Section 408(k)(6) is amended by adding at the end the following new subparagraph:

“(H) TERMINATION.—This paragraph shall not apply to years beginning after December 31, 1996. The preceding sentence shall not apply to a simplified employee pension if the terms of such pension, as in effect on December 31, 1996, provide that an employee may make the election described in subparagraph (A).”

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1996.

#### SEC. 1422. EXTENSION OF SIMPLE PLAN TO 401(k) ARRANGEMENTS.

(a) ALTERNATIVE METHOD OF SATISFYING SECTION 401(k) NONDISCRIMINATION TESTS.—Section 401(k) (relating to cash or deferred arrangements) is amended by adding at the end the following new paragraph:

“(11) ADOPTION OF SIMPLE PLAN TO MEET NONDISCRIMINATION TESTS.—

“(A) IN GENERAL.—A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets—

“(i) the contribution requirements of subparagraph (B),

“(ii) the exclusive benefit requirements of subparagraph (C), and

“(iii) the vesting requirements of section 408(p)(3).

“(B) CONTRIBUTION REQUIREMENTS.—

“(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement—

“(I) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds \$6,000,

“(II) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under subclause (I) as does not exceed 3 percent of compensation for the year, and

“(III) no other contributions may be made other than contributions described in subclause (I) or (II).

“(ii) EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.—

An employer shall be treated as meeting the requirements of clause (i)(II) for any year if, in lieu of the contributions described in such clause, the employer elects (pursuant to the terms of the arrangement) to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least \$5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 30th day before the beginning of such year.

“(C) EXCLUSIVE BENEFIT.—The requirements of this subparagraph are met for any year to which this paragraph applies if no contributions were made, or benefits were accrued, for services during such year under any qualified plan of the employer on behalf of any employee eligible to participate in the cash or deferred arrangement, other than contributions described in subparagraph (B).

“(D) DEFINITIONS AND SPECIAL RULE.—

“(i) DEFINITIONS.—For purposes of this paragraph, any term used in this paragraph which is also used in section 408(p) shall have the meaning given such term by such section.

“(ii) COORDINATION WITH TOP-HEAVY RULES.—A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year.”

(b) ALTERNATIVE METHODS OF SATISFYING SECTION 401(m) NONDISCRIMINATION TESTS.—Section 401(m) (relating to nondiscrimination test for matching contribu-

tions and employee contributions) is amended by redesignating paragraph (10) as paragraph (11) and by adding after paragraph (9) the following new paragraph:

“(10) ALTERNATIVE METHOD OF SATISFYING TESTS.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

“(A) meets the contribution requirements of subparagraph (B) of subsection (k)(11),

“(B) meets the exclusive benefit requirements of subsection (k)(11)(C), and

“(C) meets the vesting requirements of section 408(p)(3).”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1996.

### Subchapter B—Other Provisions

#### SEC. 1426. TAX-EXEMPT ORGANIZATIONS ELIGIBLE UNDER SECTION 401(k).

(a) IN GENERAL.—Subparagraph (B) of section 401(k)(4) is amended to read as follows:

“(B) ELIGIBILITY OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

“(i) TAX-EXEMPTS ELIGIBLE.—Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.

“(ii) GOVERNMENTS INELIGIBLE.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).

“(iii) TREATMENT OF INDIAN TRIBAL GOVERNMENTS.—An employer which is an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing shall be treated as an organization exempt from tax under this subtitle for purposes of clause (i).”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to plan years beginning after December 31, 1996, but shall not apply to any cash or deferred arrangement to which clause (i) of section 1116(f)(2)(B) of the Tax Reform Act of 1986 applies.

### CHAPTER 3—NONDISCRIMINATION PROVISIONS

#### SEC. 1431. DEFINITION OF HIGHLY COMPENSATED EMPLOYEES; REPEAL OF FAMILY AGGREGATION.

(a) IN GENERAL.—Paragraph (1) of section 414(q) (defining highly compensated employee) is amended to read as follows:

“(1) IN GENERAL.—The term ‘highly compensated employee’ means any employee who—

“(A) was a 5-percent owner at any time during the year or the preceding year, or

“(B) for the preceding year—

“(i) had compensation from the employer in excess of \$80,000, and

“(ii) was in the top-paid group of the employer.

The Secretary shall adjust the \$80,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1996.”

(b) REPEAL OF FAMILY AGGREGATION RULES.—

(1) IN GENERAL.—Paragraph (6) of section 414(q) is hereby repealed.

(2) COMPENSATION LIMIT.—Paragraph (17)(A) of section 401(a) is amended by striking the last sentence.

(3) DEDUCTION.—Subsection (l) of section 404 is amended by striking the last sentence.

(c) CONFORMING AMENDMENTS.—

(1)(A) Subsection (q) of section 414 is amended by striking paragraphs (2), (5), (8), and (12) and by redesignating paragraphs (3), (4), (7), (9), (10), and (11) as paragraphs (2) through (7), respectively.

(B) Sections 129(d)(8)(B), 401(a)(5)(D)(ii), 408(k)(2)(C), and 416(i)(1)(D) are each amended by striking “section 414(q)(7)” and inserting “section 414(q)(4)”.

(C) Section 416(i)(1)(A) is amended by striking “section 414(q)(8)” and inserting “section 414(r)(9)”.

(2)(A) Section 414(r) is amended by adding at the end the following new paragraph:

“(9) EXCLUDED EMPLOYEES.—For purposes of this subsection, the following employees shall be excluded:

“(A) Employees who have not completed 6 months of service.

“(B) Employees who normally work less than 17½ hours per week.

“(C) Employees who normally work not more than 6 months during any year.

“(D) Employees who have not attained the age of 21.

“(E) Except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer.

Except as provided by the Secretary, the employer may elect to apply subparagraph (A), (B), (C), or (D) by substituting a shorter period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age (as the case may be) specified in such subparagraph.”

(B) Subparagraph (A) of section 414(r)(2) is amended by striking “subsection (q)(8)” and inserting “paragraph (9)”.

(3) Section 1114(c)(4) of the Tax Reform Act of 1986 is amended by adding at the end the following new sentence: “Any reference in this paragraph to section 414(q) shall be treated as a reference to such section as in effect on the day before the date of the enactment of the Small Business Job Protection Act of 1996.”

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 1996, except that in determining whether an employee is a highly compensated employee for years beginning in 1997, such amendments shall be treated as having been in effect for years beginning in 1996.

(2) FAMILY AGGREGATION.—The amendments made by subsection (b) shall apply to years beginning after December 31, 1996.

#### SEC. 1432. MODIFICATION OF ADDITIONAL PARTICIPATION REQUIREMENTS.

(a) GENERAL RULE.—Section 401(a)(26)(A) (relating to additional participation requirements) is amended to read as follows:

“(A) IN GENERAL.—In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of—

“(i) 50 employees of the employer, or

“(ii) the greater of—

“(I) 40 percent of all employees of the employer, or

“(II) 2 employees (or if there is only 1 employee, such employee).”

(b) SEPARATE LINE OF BUSINESS TEST.—Section 401(a)(26)(G) (relating to separate line of business) is amended by striking “paragraph (7)” and inserting “paragraph (2)(A) or (7)”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

#### SEC. 1433. NONDISCRIMINATION RULES FOR QUALIFIED CASH OR DEFERRED ARRANGEMENTS AND MATCHING CONTRIBUTIONS.

(a) ALTERNATIVE METHODS OF SATISFYING SECTION 401(k) NONDISCRIMINATION TESTS.—Section 401(k) (relating to cash or deferred arrangements), as amended by section 1422, is amended by adding at the end the following new paragraph:

“(12) ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—

“(A) IN GENERAL.—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement—

“(i) meets the contribution requirements of subparagraph (B) or (C), and

“(ii) meets the notice requirements of subparagraph (D).

“(B) MATCHING CONTRIBUTIONS.—

“(i) IN GENERAL.—The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on

behalf of each employee who is not a highly compensated employee in an amount equal to—

“(I) 100 percent of the elective contributions of the employee to the extent such elective contributions do not exceed 3 percent of the employee’s compensation, and

“(II) 50 percent of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee’s compensation.

“(ii) RATE FOR HIGHLY COMPENSATED EMPLOYEES.—The requirements of this subparagraph are not met if, under the arrangement, the rate of matching contribution with respect to any elective contribution of a highly compensated employee at any rate of elective contribution is greater than that with respect to an employee who is not a highly compensated employee.

“(iii) ALTERNATIVE PLAN DESIGNS.—If the rate of any matching contribution with respect to any rate of elective contribution is not equal to the percentage required under clause (i), an arrangement shall not be treated as failing to meet the requirements of clause (i) if—

“(I) the rate of an employer’s matching contribution does not increase as an employee’s rate of elective contributions increase, and

“(II) the aggregate amount of matching contributions at such rate of elective contribution is at least equal to the aggregate amount of matching contributions which would be made if matching contributions were made on the basis of the percentages described in clause (i).

“(C) NONELECTIVE CONTRIBUTIONS.—The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly compensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee’s compensation.

“(D) NOTICE REQUIREMENT.—An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee’s rights and obligations under the arrangement which—

“(i) is sufficiently accurate and comprehensive to appraise the employee of such rights and obligations, and

“(ii) is written in a manner calculated to be understood by the average employee eligible to participate.

“(E) OTHER REQUIREMENTS.—

“(i) WITHDRAWAL AND VESTING RESTRICTIONS.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) of this paragraph unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to all employer contributions (including matching contributions) taken into account in determining whether the requirements of subparagraphs (B) and (C) of this paragraph are met.

“(ii) SOCIAL SECURITY AND SIMILAR CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (l), and, for purposes of subsection (l), employer contributions under subparagraph (B) or (C) shall not be taken into account.

“(F) OTHER PLANS.—An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement.”

(b) ALTERNATIVE METHODS OF SATISFYING SECTION 401(m) NONDISCRIMINATION TESTS.—Section 401(m) (relating to nondiscrimination test for matching contributions and employee contributions), as amended by this Act, is amended by redesignating paragraph (11) as paragraph (12) and by adding after paragraph (10) the following new paragraph:

“(11) ALTERNATIVE METHOD OF SATISFYING TESTS.—

“(A) IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—

- “(i) meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(12),
  - “(ii) meets the notice requirements of subsection (k)(12)(D), and
  - “(iii) meets the requirements of subparagraph (B).
- “(B) LIMITATION ON MATCHING CONTRIBUTIONS.—The requirements of this subparagraph are met if—
  - “(i) matching contributions on behalf of any employee may not be made with respect to an employee’s contributions or elective deferrals in excess of 6 percent of the employee’s compensation,
  - “(ii) the rate of an employer’s matching contribution does not increase as the rate of an employee’s contributions or elective deferrals increase, and
  - “(iii) the matching contribution with respect to any highly compensated employee at any rate of an employee contribution or rate of elective deferral is not greater than that with respect to an employee who is not a highly compensated employee.”
- (c) YEAR FOR COMPUTING NONHIGHLY COMPENSATED EMPLOYEE PERCENTAGE.—
  - (1) CASH OR DEFERRED ARRANGEMENTS.—Clause (ii) of section 401(k)(3)(A) is amended—
    - (A) by striking “such year” and inserting “the plan year”,
    - (B) by striking “for such plan year” and inserting “for the preceding plan year”, and
    - (C) by adding at the end the following new sentence: “An arrangement may apply this clause by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.”
  - (2) MATCHING AND EMPLOYEE CONTRIBUTIONS.—Section 401(m)(2)(A) is amended—
    - (A) by inserting “for such plan year” after “highly compensated employees”,
    - (B) by inserting “for the preceding plan year” after “eligible employees” each place it appears in clause (i) and clause (ii), and
    - (C) by adding at the end the following flush sentence: “This subparagraph may be applied by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.”
- (d) SPECIAL RULE FOR DETERMINING AVERAGE DEFERRAL PERCENTAGE FOR FIRST PLAN YEAR, ETC.—
  - (1) Paragraph (3) of section 401(k) is amended by adding at the end the following new subparagraph:
    - “(E) For purposes of this paragraph, in the case of the first plan year of any plan (other than a successor plan), the amount taken into account as the actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—
      - “(i) 3 percent, or
      - “(ii) if the employer makes an election under this subclause, the actual deferral percentage of nonhighly compensated employees determined for such first plan year.”
  - (2) Paragraph (3) of section 401(m) is amended by adding at the end the following: “Rules similar to the rules of subsection (k)(3)(E) shall apply for purposes of this subsection.”
- (e) DISTRIBUTION OF EXCESS CONTRIBUTIONS AND EXCESS AGGREGATE CONTRIBUTIONS.—
  - (1) Subparagraph (C) of section 401(k)(8) (relating to arrangement not disqualified if excess contributions distributed) is amended by striking “on the basis of the respective portions of the excess contributions attributable to each of such employees” and inserting “on the basis of the amount of contributions by, or on behalf of, each of such employees”.
  - (2) Subparagraph (C) of section 401(m)(6) (relating to method of distributing excess aggregate contributions) is amended by striking “on the basis of the respective portions of such amounts attributable to each of such employees” and inserting “on the basis of the amount of contributions on behalf of, or by, each such employee”.
- (f) EFFECTIVE DATES.—
  - (1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 1998.
  - (2) EXCEPTIONS.—The amendments made by subsections (c), (d), and (e) shall apply to years beginning after December 31, 1996.

**SEC. 1434. DEFINITION OF COMPENSATION FOR SECTION 415 PURPOSES.**

(a) GENERAL RULE.—Section 415(c)(3) (defining participant's compensation) is amended by adding at the end the following new subparagraph:

“(D) CERTAIN DEFERRALS INCLUDED.—The term ‘participant’s compensation’ shall include—

“(i) any elective deferral (as defined in section 402(g)(3)), and

“(ii) any amount which is contributed by the employer at the election of the employee and which is not includible in the gross income of the employee under section 125 or 457.”

(b) CONFORMING AMENDMENTS.—

(1) Section 414(q)(4), as redesignated by section 1431, is amended to read as follows:

“(4) COMPENSATION.—For purposes of this subsection, the term ‘compensation’ has the meaning given such term by section 415(c)(3).”

(2) Section 414(s)(2) is amended by inserting “not” after “elect” in the text and heading thereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1997.

**CHAPTER 4—MISCELLANEOUS PROVISIONS****SEC. 1441. PLANS COVERING SELF-EMPLOYED INDIVIDUALS.**

(a) AGGREGATION RULES.—Section 401(d) (relating to additional requirements for qualification of trusts and plans benefiting owner-employees) is amended to read as follows:

“(d) CONTRIBUTION LIMIT ON OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.”

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1996.

**SEC. 1442. ELIMINATION OF SPECIAL VESTING RULE FOR MULTIEMPLOYER PLANS.**

(a) IN GENERAL.—Paragraph (2) of section 411(a) (relating to minimum vesting standards) is amended—

(1) by striking “subparagraph (A), (B), or (C)” and inserting “subparagraph (A) or (B)”; and

(2) by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning on or after the earlier of—

(1) the later of—

(A) January 1, 1997, or

(B) the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates (determined without regard to any extension thereof after the date of the enactment of this Act), or

(2) January 1, 1999.

Such amendments shall not apply to any individual who does not have more than 1 hour of service under the plan on or after the 1st day of the 1st plan year to which such amendments apply.

**SEC. 1443. DISTRIBUTIONS UNDER RURAL COOPERATIVE PLANS.**

(a) DISTRIBUTIONS FOR HARDSHIP OR AFTER A CERTAIN AGE.—Section 401(k)(7) is amended by adding at the end the following new subparagraph:

“(C) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) or of paragraph (2) merely by reason of a hardship distribution or a distribution to a participant after attainment of age 59½. For purposes of this section, the term ‘hardship distribution’ means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limitation of its application to profit-sharing or stock bonus plans).”

(b) PUBLIC UTILITY DISTRICTS.—Clause (i) of section 401(k)(7)(B) (defining rural cooperative) is amended to read as follows:

“(i) any organization which—

“(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

“(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof).”.

(c) EFFECTIVE DATES.—

(1) DISTRIBUTIONS.—The amendments made by subsection (a) shall apply to distributions after the date of the enactment of this Act.

(2) RURAL COOPERATIVE.—The amendments made by subsection (b) shall apply to plan years beginning after December 31, 1996.

**SEC. 1444. TREATMENT OF GOVERNMENTAL PLANS UNDER SECTION 415.**

(a) COMPENSATION LIMIT.—Subsection (b) of section 415 is amended by adding immediately after paragraph (10) the following new paragraph:

“(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL PLANS.—In the case of a governmental plan (as defined in section 414(d)), subparagraph (B) of paragraph (1) shall not apply.”

(b) TREATMENT OF CERTAIN EXCESS BENEFIT PLANS.—

(1) IN GENERAL.—Section 415 is amended by adding at the end the following new subsection:

“(m) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—

“(1) GOVERNMENTAL PLAN NOT AFFECTED.—In determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

“(2) TAXATION OF PARTICIPANT.—For purposes of this chapter—

“(A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and

“(B) the treatment of such amounts when so includible by the participant, shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.

“(3) QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENT.—For purposes of this subsection, the term ‘qualified governmental excess benefit arrangement’ means a portion of a governmental plan if—

“(A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant’s annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by this section,

“(B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation, and

“(C) benefits described in subparagraph (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.”

(2) COORDINATION WITH SECTION 457.—Subsection (e) of section 457 is amended by adding at the end the following new paragraph:

“(14) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—Subsections (b)(2) and (c)(1) shall not apply to any qualified governmental excess benefit arrangement (as defined in section 415(m)(3)), and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan.”

(3) CONFORMING AMENDMENT.—Paragraph (2) of section 457(f) is amended by striking “and” at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting “, and”, and by inserting immediately thereafter the following new subparagraph:

“(E) a qualified governmental excess benefit arrangement described in section 415(m).”

(c) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS.—Paragraph (2) of section 415(b) is amended by adding at the end the following new subparagraph:

“(I) EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL PLANS.—Subparagraph (C) of this paragraph and paragraph (5) shall not apply to—

“(i) income received from a governmental plan (as defined in section 414(d)) as a pension, annuity, or similar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or

“(ii) amounts received from a governmental plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee.”

(d) REVOCATION OF GRANDFATHER ELECTION.—

(1) IN GENERAL.—Subparagraph (C) of section 415(b)(10) is amended by adding at the end the following new clause:

“(ii) REVOCATION OF ELECTION.—An election under clause (i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation shall apply to all plan years to which the election applied and to all subsequent plan years. Any amount paid by a plan in a taxable year ending after the revocation shall be includible in income in such taxable year under the rules of this chapter in effect for such taxable year, except that, for purposes of applying the limitations imposed by this section, any portion of such amount which is attributable to any taxable year during which the election was in effect shall be treated as received in such taxable year.”

(2) CONFORMING AMENDMENT.—Subparagraph (C) of section 415(b)(10) is amended by striking “This” and inserting:

“(i) IN GENERAL.—This”.

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by subsections (a), (b), and (c) shall apply to years beginning after December 31, 1994. The amendments made by subsection (d) shall apply with respect to revocations adopted after the date of the enactment of this Act.

(2) TREATMENT FOR YEARS BEGINNING BEFORE JANUARY 1, 1995.—Nothing in the amendments made by this section shall be construed to infer that a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986) fails to satisfy the requirements of section 415 of such Code for any taxable year beginning before January 1, 1995.

#### SEC. 1445. UNIFORM RETIREMENT AGE.

(a) DISCRIMINATION TESTING.—Paragraph (5) of section 401(a) (relating to special rules relating to nondiscrimination requirements) is amended by adding at the end the following new subparagraph:

“(F) SOCIAL SECURITY RETIREMENT AGE.—For purposes of testing for discrimination under paragraph (4)—

“(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and

“(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee’s social security retirement age (as so defined).”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1996.

#### SEC. 1446. CONTRIBUTIONS ON BEHALF OF DISABLED EMPLOYEES.

(a) ALL DISABLED PARTICIPANTS RECEIVING CONTRIBUTIONS.—Section 415(c)(3)(C) is amended by adding at the end the following: “If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period, this subparagraph shall be applied without regard to clauses (ii) and (iii).”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 1996.

#### SEC. 1447. TREATMENT OF DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) SPECIAL RULES FOR PLAN DISTRIBUTIONS.—Paragraph (9) of section 457(e) (relating to other definitions and special rules) is amended to read as follows:



“(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—

“(A) TOTAL AMOUNT PAYABLE IS \$3,500 OR LESS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant’s consent) if—

“(i) such amount does not exceed \$3,500, and

“(ii) such amount may be distributed only if—

“(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and

“(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.

A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.

“(B) ELECTION TO DEFER COMMENCEMENT OF DISTRIBUTIONS.—The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if—

“(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and

“(ii) the participant may make only 1 such election.”

(b) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—Subsection (e) of section 457, as amended by section 1444(b)(2) (relating to governmental plans), is amended by adding at the end the following new paragraph:

“(15) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—The Secretary shall adjust the \$7,500 amount specified in subsections (b)(2) and (c)(1) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1994, and any increase under this paragraph which is not a multiple of \$500 shall be rounded to the next lowest multiple of \$500.”

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1996.

**SEC. 1448. TRUST REQUIREMENT FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS.**

(a) IN GENERAL.—Section 457 is amended by adding at the end the following new subsection:

“(g) GOVERNMENTAL PLANS MUST MAINTAIN SET-ASIDES FOR EXCLUSIVE BENEFIT OF PARTICIPANTS.—

“(1) IN GENERAL.—A plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries.

“(2) TAXABILITY OF TRUSTS AND PARTICIPANTS.—For purposes of this title—

“(A) a trust described in paragraph (1) shall be treated as an organization exempt from taxation under section 501(a), and

“(B) notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

“(3) CUSTODIAL ACCOUNTS AND CONTRACTS.—For purposes of this subsection, custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).”

(b) CONFORMING AMENDMENT.—Paragraph (6) of section 457(b) is amended by inserting “except as provided in subsection (g),” before “which provides that”.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to assets and income described in section 457(b)(6) of the Internal Revenue Code of 1986 held by a plan on and after the date of the enactment of this Act.

(2) TRANSITION RULE.—In the case of assets and income described in paragraph (1) held by a plan on the date of the enactment of this Act, a trust need not be established by reason of the amendments made by this section before January 1, 1999.

**SEC. 1449. TRANSITION RULE FOR COMPUTING MAXIMUM BENEFITS UNDER SECTION 415 LIMITATIONS.**

(a) **IN GENERAL.**—Subparagraph (A) of section 767(d)(3) of the Uruguay Round Agreements Act is amended to read as follows:

“(A) **EXCEPTION.**—A plan that was adopted and in effect before December 8, 1994, shall not be required to apply the amendments made by subsection (b) with respect to benefits accrued before the earlier of—

“(i) the later of the date a plan amendment applying such amendment is adopted or made effective, or

“(ii) the first day of the first limitation year beginning after December 31, 1999.

Determinations under section 415(b)(2)(E) of the Internal Revenue Code of 1986 before such earlier date shall be made with respect to such benefits on the basis of such section as in effect on December 7, 1994 (except that the modification made by section 1449(b) of the Small Business Job Protection Act of 1996 shall be taken into account), and the provisions of the plan as in effect on December 7, 1994, but only if such provisions of the plan meet the requirements of such section (as so in effect).”

(b) **MODIFICATION OF CERTAIN ASSUMPTIONS FOR ADJUSTING BENEFITS OF DEFINED BENEFIT PLANS FOR EARLY RETIREES.**—Subparagraph (E) of section 415(b)(2) (relating to limitation on certain assumptions) is amended—

(1) by striking “Except as provided in clause (ii), for purposes of adjusting any benefit or limitation under subparagraph (B) or (C),” in clause (i) and inserting “For purposes of adjusting any limitation under subparagraph (C) and, except as provided in clause (ii), for purposes of adjusting any benefit under subparagraph (B),” and

(2) by striking “For purposes of adjusting the benefit or limitation of any form of benefit subject to section 417(e)(3),” in clause (ii) and inserting “For purposes of adjusting any benefit under subparagraph (B) for any form of benefit subject to section 417(e)(3),”

(c) **EFFECTIVE DATE.**—The amendments made by this section shall take effect as if included in the provisions of section 767 of the Uruguay Round Agreements Act.

(d) **TRANSITIONAL RULE.**—In the case of a plan that was adopted and in effect before December 8, 1994, if—

(1) a plan amendment was adopted or made effective on or before the date of the enactment of this Act applying the amendments made by section 767 of the Uruguay Round Agreements Act, and

(2) within 1 year after the date of the enactment of this Act, a plan amendment is adopted which repeals the amendment referred to in paragraph (1), the amendment referred to in paragraph (1) shall not be taken into account in applying section 767(d)(3)(A) of the Uruguay Round Agreements Act, as amended by subsection (a).

**SEC. 1450. MODIFICATIONS OF SECTION 403(b).**

(a) **MULTIPLE SALARY REDUCTION AGREEMENTS PERMITTED.**—

(1) **GENERAL RULE.**—For purposes of section 403(b) of the Internal Revenue Code of 1986, the frequency that an employee is permitted to enter into a salary reduction agreement, the salary to which such an agreement may apply, and the ability to revoke such an agreement shall be determined under the rules applicable to cash or deferred elections under section 401(k) of such Code.

(2) **EFFECTIVE DATE.**—This subsection shall apply to taxable years beginning after December 31, 1995.

(b) **TREATMENT OF INDIAN TRIBAL GOVERNMENTS.**—

(1) **IN GENERAL.**—In the case of any contract purchased in a plan year beginning before January 1, 1995, section 403(b) of the Internal Revenue Code of 1986 shall be applied as if any reference to an employer described in section 501(c)(3) of the Internal Revenue Code of 1986 which is exempt from tax under section 501 of such Code included a reference to an employer which is an Indian tribal government (as defined by section 7701(a)(40) of such Code), a subdivision of an Indian tribal government (determined in accordance with section 7871(d) of such Code), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing.

(2) **ROLLOVERS.**—Solely for purposes of applying section 403(b)(8) of such Code to a contract to which paragraph (1) applies, a qualified cash or deferred arrangement under section 401(k) of such Code shall be treated as if it were a plan or contract described in clause (ii) of section 403(b)(8)(A) of such Code.

(c) **ELECTIVE DEFERRALS.**—

(1) IN GENERAL.—Subparagraph (E) of section 403(b)(1) is amended to read as follows:

“(E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30).”

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 1995, except a contract shall not be required to meet any change in any requirement by reason of such amendment before the 90th day after the date of the enactment of this Act.

**SEC. 1451. WAIVER OF MINIMUM PERIOD FOR JOINT AND SURVIVOR ANNUITY EXPLANATION BEFORE ANNUITY STARTING DATE.**

(a) GENERAL RULE.—For purposes of section 417(a)(3)(A) of the Internal Revenue Code of 1986 (relating to plan to provide written explanations), the minimum period prescribed by the Secretary of the Treasury between the date that the explanation referred to in such section is provided and the annuity starting date shall not apply if waived by the participant and, if applicable, the participant’s spouse.

(b) EFFECTIVE DATE.—Subsection (a) shall apply to plan years beginning after December 31, 1996.

**SEC. 1452. REPEAL OF LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE; EXCESS DISTRIBUTIONS.**

(a) IN GENERAL.—Section 415(e) is repealed.

(b) EXCESS DISTRIBUTIONS.—Section 4980A is amended by adding at the end the following new subsection:

“(g) LIMITATION ON APPLICATION.—This section shall not apply to distributions during years beginning after December 31, 1995, and before January 1, 1999, and such distributions shall be treated as made first from amounts not described in subsection (f).”

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 415(a) is amended—

(A) by adding “or” at the end of subparagraph (A),

(B) by striking “, or” at the end of subparagraph (B) and inserting a period, and

(C) by striking subparagraph (C).

(2) Subparagraph (B) of section 415(b)(5) is amended by striking “and subsection (e)”.

(3) Paragraph (1) of section 415(f) is amended by striking “subsections (b), (c), and (e)” and inserting “subsections (b) and (c)”.

(4) Subsection (g) of section 415 is amended by striking “subsections (e) and (f)” in the last sentence and inserting “subsection (f)”.

(5) Clause (i) of section 415(k)(2)(A) is amended to read as follows:

“(i) any contribution made directly by an employee under such an arrangement shall not be treated as an annual addition for purposes of subsection (c), and”.

(6) Clause (ii) of section 415(k)(2)(A) is amended by striking “subsections (c) and (e)” and inserting “subsection (c)”.

(7) Section 416 is amended by striking subsection (h).

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to limitation years beginning after December 31, 1998.

(2) EXCESS DISTRIBUTIONS.—The amendment made by subsection (b) shall apply to years beginning after December 31, 1995.

**SEC. 1453. TAX ON PROHIBITED TRANSACTIONS.**

(a) IN GENERAL.—Section 4975(a) is amended by striking “5 percent” and inserting “10 percent”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to prohibited transactions occurring after the date of the enactment of this Act.

**SEC. 1454. TREATMENT OF LEASED EMPLOYEES.**

(a) GENERAL RULE.—Subparagraph (C) of section 414(n)(2) (defining leased employee) is amended to read as follows:

“(C) such services are performed under primary direction or control by the recipient.”

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1996, but shall not apply to any relationship determined under an Internal Revenue Service ruling issued before the date of the enactment of this Act pursuant to section 414(n)(2)(C) of the Internal Revenue Code of 1986 (as in effect on the day before such date) not to involve a leased employee.

**SEC. 1455. UNIFORM PENALTY PROVISIONS TO APPLY TO CERTAIN PENSION REPORTING REQUIREMENTS.**

(a) **PENALTIES.**—

(1) **STATEMENTS.**—Paragraph (1) of section 6724(d) is amended by striking “and” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, and”, and by inserting after subparagraph (B) the following new subparagraph:

“(C) any statement of the amount of payments to another person required to be made to the Secretary under—

“(i) section 408(i) (relating to reports with respect to individual retirement accounts or annuities), or

“(ii) section 6047(d) (relating to reports by employers, plan administrators, etc.).”

(2) **REPORTS.**—Paragraph (2) of section 6724(d), as amended by section 1116, is amended by striking “or” at the end of subparagraph (T), by striking the period at the end of subparagraph (U) and inserting a comma, and by inserting after subparagraph (U) the following new subparagraphs:

“(V) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person, or

“(W) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person.”

(b) **MODIFICATION OF REPORTABLE DESIGNATED DISTRIBUTIONS.**—

(1) **SECTION 408.**—Subsection (i) of section 408 (relating to individual retirement account reports) is amended by inserting “aggregating \$10 or more in any calendar year” after “distributions”.

(2) **SECTION 6047.**—Paragraph (1) of section 6047(d) (relating to reports by employers, plan administrators, etc.) is amended by adding at the end the following new sentence: “No return or report may be required under the preceding sentence with respect to distributions to any person during any year unless such distributions aggregate \$10 or more.”

(c) **QUALIFYING ROLLOVER DISTRIBUTIONS.**—Section 6652(i) is amended—

(1) by striking “the \$10” and inserting “\$100”, and

(2) by striking “\$5,000” and inserting “\$50,000”.

(d) **CONFORMING AMENDMENTS.**—

(1) Paragraph (1) of section 6047(f) is amended to read as follows:

“(1) For provisions relating to penalties for failures to file returns and reports required under this section, see sections 6652(e), 6721, and 6722.”

(2) Subsection (e) of section 6652 is amended by adding at the end the following new sentence: “This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(W).”

(3) Subsection (a) of section 6693 is amended by adding at the end the following new sentence: “This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(V).”

(e) **EFFECTIVE DATE.**—The amendments made by this section shall apply to returns, reports, and other statements the due date for which (determined without regard to extensions) is after December 31, 1996.

**SEC. 1456. RETIREMENT BENEFITS OF MINISTERS NOT SUBJECT TO TAX ON NET EARNINGS FROM SELF-EMPLOYMENT.**

(a) **IN GENERAL.**—Section 1402(a)(8) (defining net earning from self-employment) is amended by inserting “, but shall not include in such net earnings from self-employment the rental value of any parsonage (whether or not excludable under section 107) provided after the individual retires, or any other retirement benefit received by such individual from a church plan (as defined in section 414(e)) after the individual retires” before the semicolon at the end.

(b) **EFFECTIVE DATE.**—The amendments made by this section shall apply to years beginning before, on, or after December 31, 1994.

**SEC. 1457. DATE FOR ADOPTION OF PLAN AMENDMENTS.**

If any amendment made by this subtitle requires an amendment to any plan or annuity contract, such amendment shall not be required to be made before the first day of the first plan year beginning on or after January 1, 1997, if—

- (1) during the period after such amendment takes effect and before such first plan year, the plan or contract is operated in accordance with the requirements of such amendment, and
  - (2) such amendment applies retroactively to such period.
- In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), this section shall be applied by substituting “1999” for “1997”.

## Subtitle E—Foreign Simplification

### SEC. 1501. REPEAL OF INCLUSION OF CERTAIN EARNINGS INVESTED IN EXCESS PASSIVE ASSETS.

#### (a) IN GENERAL.—

(1) REPEAL OF INCLUSION.—Paragraph (1) of section 951(a) (relating to amounts included in gross income of United States shareholders) is amended by striking subparagraph (C), by striking “; and” at the end of subparagraph (B) and inserting a period, and by adding “and” at the end of subparagraph (A).

(2) REPEAL OF INCLUSION AMOUNT.—Section 956A (relating to earnings invested in excess passive assets) is repealed.

#### (b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 956(b) is amended to read as follows:

“(1) APPLICABLE EARNINGS.—For purposes of this section, the term ‘applicable earnings’ means, with respect to any controlled foreign corporation, the sum of—

“(A) the amount (not including a deficit) referred to in section 316(a)(1), and

“(B) the amount referred to in section 316(a)(2), but reduced by distributions made during the taxable year.”

(2) Paragraph (3) of section 956(b) is amended to read as follows:

“(3) SPECIAL RULE WHERE CORPORATION CEASES TO BE CONTROLLED FOREIGN CORPORATION.—If any foreign corporation ceases to be a controlled foreign corporation during any taxable year—

“(A) the determination of any United States shareholder’s pro rata share shall be made on the basis of stock owned (within the meaning of section 958(a)) by such shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation,

“(B) the average referred to in subsection (a)(1)(A) for such taxable year shall be determined by only taking into account quarters ending on or before such last day, and

“(C) in determining applicable earnings, the amount taken into account by reason of being described in paragraph (2) of section 316(a) shall be the portion of the amount so described which is allocable (on a pro rata basis) to the part of such year during which the corporation is a controlled foreign corporation.”

(3) Subsection (a) of section 959 (relating to exclusion from gross income of previously taxed earnings and profits) is amended by adding “or” at the end of paragraph (1), by striking “or” at the end of paragraph (2), and by striking paragraph (3).

(4) Subsection (a) of section 959 is amended by striking “paragraphs (2) and (3)” in the last sentence and inserting “paragraph (2)”.

(5) Subsection (c) of section 959 is amended by adding at the end the following flush sentence:

“References in this subsection to section 951(a)(1)(C) and subsection (a)(3) shall be treated as references to such provisions as in effect on the day before the date of the enactment of the Small Business Job Protection Act of 1996.”

(6) Paragraph (1) of section 959(f) is amended to read as follows:

“(1) IN GENERAL.—For purposes of this section, amounts that would be included under subparagraph (B) of section 951(a)(1) (determined without regard to this section) shall be treated as attributable first to earnings described in subsection (c)(2), and then to earnings described in subsection (c)(3).”

(7) Paragraph (2) of section 959(f) is amended by striking “subparagraphs (B) and (C) of section 951(a)(1)” and inserting “section 951(a)(1)(B)”.

(8) Subsection (b) of section 989 is amended by striking “subparagraph (B) or (C) of section 951(a)(1)” and inserting “section 951(a)(1)(B)”.

(9) Paragraph (9) of section 1297(b) is amended by striking “subparagraph (B) or (C) of section 951(a)(1)” and inserting “section 951(a)(1)(B)”.

- (10) Subsections (d)(3)(B) and (e)(2)(B)(ii) of section 1297 are each amended by striking “or section 956A”.
- (c) CLERICAL AMENDMENT.—The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking the item relating to section 956A.
- (d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 1996, and to taxable years of United States shareholders within which or with which such taxable years of foreign corporations end.

## Subtitle F—Revenue Offsets

### SEC. 1601. TERMINATION OF PUERTO RICO AND POSSESSION TAX CREDIT.

(a) IN GENERAL.—Section 936 is amended by adding at the end the following new subsection:

“(j) TERMINATION.—

“(1) IN GENERAL.—Except as otherwise provided in this subsection, this section shall not apply to any taxable year beginning after December 31, 1995.

“(2) TRANSITION RULES FOR ACTIVE BUSINESS INCOME CREDIT.—Except as provided in paragraph (3)—

“(A) ECONOMIC ACTIVITY CREDIT.—In the case of an existing credit claimant—

“(i) with respect to a possession other than Puerto Rico, and

“(ii) to which subsection (a)(4)(B) does not apply,

the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 2002.

“(B) SPECIAL RULE FOR REDUCED CREDIT.—

“(i) IN GENERAL.—In the case of an existing credit claimant to which subsection (a)(4)(B) applies, the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 1998.

“(ii) ELECTION IRREVOCABLE AFTER 1997.—An election under subsection (a)(4)(B)(iii) which is in effect for the taxpayer's last taxable year beginning before 1997 may not be revoked unless it is revoked for the taxpayer's first taxable year beginning in 1997 and all subsequent taxable years.

“(C) ECONOMIC ACTIVITY CREDIT FOR PUERTO RICO.—

“**For economic activity credit for Puerto Rico, see section 30A.**

“(3) ADDITIONAL RESTRICTED CREDIT.—

“(A) IN GENERAL.—In the case of an existing credit claimant—

“(i) the credit under subsection (a)(1)(A) shall be allowed for the period beginning with the first taxable year after the last taxable year to which subparagraph (A) or (B) of paragraph (2), whichever is appropriate, applied and ending with the last taxable year beginning before January 1, 2006, except that

“(ii) the aggregate amount of taxable income taken into account under subsection (a)(1)(A) for any such taxable year shall not exceed the adjusted base period income of such claimant.

“(B) COORDINATION WITH SUBSECTION (a)(4).—The amount of income described in subsection (a)(1)(A) which is taken into account in applying subsection (a)(4) shall be such income as reduced under this paragraph.

“(4) ADJUSTED BASE PERIOD INCOME.—For purposes of paragraph (3)—

“(A) IN GENERAL.—The term ‘adjusted base period income’ means the average of the inflation-adjusted possession incomes of the corporation for each base period year.

“(B) INFLATION-ADJUSTED POSSESSION INCOME.—For purposes of subparagraph (A), the inflation-adjusted possession income of any corporation for any base period year shall be an amount equal to the sum of—

“(i) the possession income of such corporation for such base period year, plus

“(ii) such possession income multiplied by the inflation adjustment percentage for such base period year.

“(C) INFLATION ADJUSTMENT PERCENTAGE.—For purposes of subparagraph (B), the inflation adjustment percentage for any base period year means the percentage (if any) by which—

“(i) the CPI for 1995, exceeds

“(ii) the CPI for the calendar year in which the base period year for which the determination is being made ends.  
For purposes of the preceding sentence, the CPI for any calendar year is the CPI (as defined in section 1(f)(5)) for such year under section 1(f)(4).

“(D) INCREASE IN INFLATION ADJUSTMENT PERCENTAGE FOR GROWTH DURING BASE YEARS.—The inflation adjustment percentage (determined under subparagraph (C) without regard to this subparagraph) for each of the 5 taxable years referred to in paragraph (5)(A) shall be increased by—

“(i) 5 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1995;

“(ii) 10.25 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1994;

“(iii) 15.76 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1993;

“(iv) 21.55 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1992; and

“(v) 27.63 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1991.

“(5) BASE PERIOD YEAR.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘base period year’ means each of 3 taxable years which are among the 5 most recent taxable years of the corporation ending before October 14, 1995, determined by disregarding—

“(i) one taxable year for which the corporation had the largest inflation-adjusted possession income, and

“(ii) one taxable year for which the corporation had the smallest inflation-adjusted possession income.

“(B) CORPORATIONS NOT HAVING SIGNIFICANT POSSESSION INCOME THROUGHOUT 5-YEAR PERIOD.—

“(i) IN GENERAL.—If a corporation does not have significant possession income for each of the most recent 5 taxable years ending before October 14, 1995, then, in lieu of applying subparagraph (A), the term ‘base period year’ means only those taxable years (of such 5 taxable years) for which the corporation has significant possession income; except that, if such corporation has significant possession income for 4 of such 5 taxable years, the rule of subparagraph (A)(ii) shall apply.

“(ii) SPECIAL RULE.—If there is no year (of such 5 taxable years) for which a corporation has significant possession income—

“(I) the term ‘base period year’ means the first taxable year ending on or after October 14, 1995, but

“(II) the amount of possession income for such year which is taken into account under paragraph (4) shall be the amount which would be determined if such year were a short taxable year ending on September 30, 1995.

“(iii) SIGNIFICANT POSSESSION INCOME.—For purposes of this subparagraph, the term ‘significant possession income’ means possession income which exceeds 2 percent of the possession income of the taxpayer for the taxable year (of the period of 6 taxable years ending with the first taxable year ending on or after October 14, 1995) having the greatest possession income.

“(C) ELECTION TO USE ONE BASE PERIOD YEAR.—

“(i) IN GENERAL.—At the election of the taxpayer, the term ‘base period year’ means—

“(I) only the last taxable year of the corporation ending in calendar year 1992, or

“(II) a deemed taxable year which includes the first ten months of calendar year 1995.

“(ii) BASE PERIOD INCOME FOR 1995.—In determining the adjusted base period income of the corporation for the deemed taxable year under clause (i)(II), the possession income shall be annualized and shall be determined without regard to any extraordinary item.

“(iii) ELECTION.—An election under this subparagraph by any possession corporation may be made only for the corporation’s first taxable year beginning after December 31, 1995, for which it is a possession corporation. The rules of subclauses (II) and (III) of subsection (a)(4)(B)(iii) shall apply to the election under this subparagraph.

“(D) ACQUISITIONS AND DISPOSITIONS.—Rules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of this subsection.

“(6) POSSESSION INCOME.—For purposes of this subsection, the term ‘possession income’ means, with respect to any possession, the income referred to in subsection (a)(1)(A) determined with respect to that possession. In no event shall possession income be treated as being less than zero.

“(7) SHORT YEARS.—If the current year or a base period year is a short taxable year, the application of this subsection shall be made with such annualizations as the Secretary shall prescribe.

“(8) SPECIAL RULES FOR CERTAIN POSSESSIONS.—

“(A) IN GENERAL.—In the case of an existing credit claimant with respect to an applicable possession, this section (other than the preceding paragraphs of this subsection) shall apply to such claimant with respect to such applicable possession for taxable years beginning after December 31, 1995, and before January 1, 2006.

“(B) APPLICABLE POSSESSION.—For purposes of this paragraph, the term ‘applicable possession’ means Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

“(9) EXISTING CREDIT CLAIMANT.—For purposes of this subsection—

“(A) IN GENERAL.—The term ‘existing credit claimant’ means a corporation—

“(i) which was actively conducting a trade or business in a possession on October 13, 1995, and

“(ii) with respect to which an election under this section is in effect for the corporation’s taxable year which includes October 13, 1995.

“(B) NEW LINES OF BUSINESS PROHIBITED.—If, after October 13, 1995, a corporation which would (but for this subparagraph) be an existing credit claimant adds a substantial new line of business, such corporation shall cease to be treated as an existing credit claimant as of the close of the taxable year ending before the date of such addition.

“(C) BINDING CONTRACT EXCEPTION.—If, on October 13, 1995, and at all times thereafter, there is in effect with respect to a corporation a binding contract for the acquisition of assets to be used in, or for the sale of assets to be produced from, a trade or business, the corporation shall be treated for purposes of this paragraph as actively conducting such trade or business on October 13, 1995. The preceding sentence shall not apply if such trade or business is not actively conducted before January 1, 1996.

“(10) SEPARATE APPLICATION TO EACH POSSESSION.—For purposes of determining—

“(A) whether a taxpayer is an existing credit claimant, and

“(B) the amount of the credit allowed under this section, this subsection (and so much of this section as relates to this subsection) shall be applied separately with respect to each possession.”

(b) ECONOMIC ACTIVITY CREDIT FOR PUERTO RICO.—

(1) IN GENERAL.—Subpart B of part IV of subchapter A of chapter 1 is amended by adding at the end the following new section:

**“SEC. 30A. PUERTO RICAN ECONOMIC ACTIVITY CREDIT.**

“(a) ALLOWANCE OF CREDIT.—

“(1) IN GENERAL.—Except as otherwise provided in this section, if the conditions of both paragraph (1) and paragraph (2) of subsection (b) are satisfied with respect to a qualified domestic corporation, there shall be allowed as a credit against the tax imposed by this chapter an amount equal to the portion of the tax which is attributable to the taxable income, from sources without the United States, from—

“(A) the active conduct of a trade or business within Puerto Rico, or

“(B) the sale or exchange of substantially all of the assets used by the taxpayer in the active conduct of such trade or business.

In the case of any taxable year beginning after December 31, 2001, the aggregate amount of taxable income taken into account under the preceding sentence (and in applying subsection (d)) shall not exceed the adjusted base period income of such corporation, as determined in the same manner as under section 936(j).

“(2) QUALIFIED DOMESTIC CORPORATION.—For purposes of paragraph (1), the term ‘qualified domestic corporation’ means a domestic corporation—

“(A) which is an existing credit claimant with respect to Puerto Rico, and

“(B) with respect to which section 936(a)(4)(B) does not apply for the taxable year.

“(3) SEPARATE APPLICATION.—For purposes of determining—



- “(A) whether a taxpayer is an existing credit claimant with respect to Puerto Rico, and
- “(B) the amount of the credit allowed under this section, this section (and so much of section 936 as relates to this section) shall be applied separately with respect to Puerto Rico.
- “(b) CONDITIONS WHICH MUST BE SATISFIED.—The conditions referred to in subsection (a) are—
- “(1) 3-YEAR PERIOD.—If 80 percent or more of the gross income of the qualified domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession (determined without regard to section 904(f)).
- “(2) TRADE OR BUSINESS.—If 75 percent or more of the gross income of the qualified domestic corporation for such period or such part thereof was derived from the active conduct of a trade or business within a possession.
- “(c) CREDIT NOT ALLOWED AGAINST CERTAIN TAXES.—The credit provided by subsection (a) shall not be allowed against the tax imposed by—
- “(1) section 59A (relating to environmental tax),
- “(2) section 531 (relating to the tax on accumulated earnings),
- “(3) section 541 (relating to personal holding company tax), or
- “(4) section 1351 (relating to recoveries of foreign expropriation losses).
- “(d) LIMITATIONS ON CREDIT FOR ACTIVE BUSINESS INCOME.—The amount of the credit determined under subsection (a) for any taxable year shall not exceed the sum of the following amounts:
- “(1) 60 percent of the sum of—
- “(A) the aggregate amount of the qualified domestic corporation’s qualified possession wages for such taxable year, plus
- “(B) the allocable employee fringe benefit expenses of the qualified domestic corporation for such taxable year.
- “(2) The sum of—
- “(A) 15 percent of the depreciation allowances for the taxable year with respect to short-life qualified tangible property,
- “(B) 40 percent of the depreciation allowances for the taxable year with respect to medium-life qualified tangible property, and
- “(C) 65 percent of the depreciation allowances for the taxable year with respect to long-life qualified tangible property.
- “(3) If the qualified domestic corporation does not have an election to use the method described in section 936(h)(5)(C)(ii) (relating to profit split) in effect for the taxable year, the amount of the qualified possession income taxes for the taxable year allocable to nonsheltered income.
- “(e) ADMINISTRATIVE PROVISIONS.—For purposes of this title—
- “(1) the provisions of section 936 (including any applicable election thereunder) shall apply in the same manner as if the credit under this section were a credit under section 936(a)(1)(A) for a domestic corporation to which section 936(a)(4)(A) applies,
- “(2) the credit under this section shall be treated in the same manner as the credit under section 936, and
- “(3) a corporation to which this section applies shall be treated in the same manner as if it were a corporation electing the application of section 936.
- “(f) DEFINITIONS.—For purposes of this section, any term used in this section which is also used in section 936 shall have the same meaning given such term by section 936.
- “(g) APPLICATION OF SECTION.—This section shall apply to taxable years beginning after December 31, 1995, and before January 1, 2006.”
- (2) CONFORMING AMENDMENTS.—
- (A) Paragraph (1) of section 55(c) is amended by striking “and the section 936 credit allowable under section 27(b)” and inserting “, the section 936 credit allowable under section 27(b), and the Puerto Rican economic activity credit under section 30A”.
- (B) Subclause (I) of section 56(g)(4)(C)(ii) is amended—
- (i) by inserting “30A,” before “936”, and
- (ii) by striking “and (i)” and inserting “, (i), and (j)”.
- (C) Clause (iii) of section 56(g)(4)(C) is amended by adding at the end the following new subclause:
- “(VI) APPLICATION TO SECTION 30A CORPORATIONS.—References in this clause to section 936 shall be treated as including references to section 30A.”

(D) Subsection (b) of section 59 is amended by striking “section 936,” and all that follows and inserting “section 30A or 936, alternative minimum taxable income shall not include any income with respect to which a credit is determined under section 30A or 936.”

(E) The table of sections for subpart B of part IV of subchapter A of chapter 1 is amended by adding at the end the following new item:

“Sec. 30A. Puerto Rican economic activity credit.”

(F)(i) The heading for subpart B of part IV of subchapter A of chapter 1 is amended to read as follows:

### “Subpart B—Other Credits”.

(ii) The table of subparts for part IV of subchapter A of chapter 1 is amended by striking the item relating to subpart B and inserting the following new item:

“Subpart B. Other credits.”

(c) **EFFECTIVE DATE.**—The amendments made by this section shall apply to taxable years beginning after December 31, 1995.

#### **SEC. 1602. REPEAL OF EXCLUSION FOR INTEREST ON LOANS USED TO ACQUIRE EMPLOYER SECURITIES.**

(a) **IN GENERAL.**—Section 133 (relating to interest on certain loans used to acquire employer securities) is hereby repealed.

(b) **CONFORMING AMENDMENTS.**—

(1) Subparagraph (B) of section 291(e)(1) is amended by striking clause (iv) and by redesignating clause (v) as clause (iv).

(2) Section 812 is amended by striking subsection (g).

(3) Paragraph (5) of section 852(b) is amended by striking subparagraph (C).

(4) Paragraph (2) of section 4978(b) is amended by striking subparagraph (A) and all that follows and inserting the following:

“(A) first from qualified securities to which section 1042 applied acquired during the 3-year period ending on the date of the disposition, beginning with the securities first so acquired, and

“(B) then from any other employer securities.

If subsection (d) applies to a disposition, the disposition shall be treated as made from employer securities in the opposite order of the preceding sentence.”.

(5)(A) Section 4978B (relating to tax on disposition of employer securities to which section 133 applied) is hereby repealed.

(B) The table of sections for chapter 43 is amended by striking the item relating to section 4978B.

(6) Subsection (e) of section 6047 is amended by striking paragraphs (1), (2), and (3) and inserting the following new paragraphs:

“(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan which holds stock with respect to which section 404(k) applies to dividends paid on such stock, or

“(2) both such employer or plan administrator.”.

(7) Subsection (f) of section 7872 is amended by striking paragraph (12).

(8) The table of sections for part III of subchapter B of chapter 1 is amended by striking the item relating to section 133.

(c) **EFFECTIVE DATE.**—

(1) **IN GENERAL.**—The amendments made by this section shall apply to loans made after October 13, 1995.

(2) **REFINANCINGS.**—The amendments made by this section shall not apply to loans made after October 13, 1995, to refinance securities acquisition loans (determined without regard to section 133(b)(1)(B) of the Internal Revenue Code of 1986, as in effect on the day before the date of the enactment of this Act) made on or before such date or to refinance loans described in this paragraph if—

(A) the refinancing loans meet the requirements of section 133 of such Code (as so in effect),

(B) immediately after the refinancing the principal amount of the loan resulting from the refinancing does not exceed the principal amount of the refinanced loan (immediately before the refinancing), and

(C) the term of such refinancing loan does not extend beyond the last day of the term of the original securities acquisition loan.

For purposes of this paragraph, the term “securities acquisition loan” includes a loan from a corporation to an employee stock ownership plan described in section 133(b)(3) of such Code (as so in effect).

(3) EXCEPTION.—Any loan made pursuant to a binding written contract in effect on October 13, 1995, and at all times thereafter before such loan is made, shall be treated for purposes of paragraphs (1) and (2) as a loan made before such date.

**SEC. 1603. CERTAIN AMOUNTS DERIVED FROM FOREIGN CORPORATIONS TREATED AS UNRELATED BUSINESS TAXABLE INCOME.**

(a) GENERAL RULE.—Subsection (b) of section 512 (relating to modifications) is amended by adding at the end the following new paragraph:

“(17) TREATMENT OF CERTAIN AMOUNTS DERIVED FROM FOREIGN CORPORATIONS.—

“(A) IN GENERAL.—Notwithstanding paragraph (1), any amount included in gross income under section 951(a)(1)(A) shall be included as an item of gross income derived from an unrelated trade or business to the extent the amount so included is attributable to insurance income (as defined in section 953) which, if derived directly by the organization, would be treated as gross income from an unrelated trade or business. There shall be allowed all deductions directly connected with amounts included in gross income under the preceding sentence.

“(B) EXCEPTION.—Subparagraph (A) shall not apply to income attributable to a policy of insurance or reinsurance with respect to which the person (directly or indirectly) insured is—

“(i) such organization,

“(ii) an affiliate of such organization which is exempt from tax under section 501(a), or

“(iii) a director or officer of, or an individual who (directly or indirectly) performs services for, such organization or affiliate but only if the insurance covers primarily risks associated with the performance of services in connection with such organization or affiliate.

For purposes of this subparagraph, the determination as to whether an entity is an affiliate of an organization shall be made under rules similar to the rules of section 168(h)(4)(B).

“(C) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations for the application of this paragraph in the case of income paid through 1 or more entities or between 2 or more chains of entities.”

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts included in gross income in any taxable year beginning after December 31, 1995.

**SEC. 1604. DEPRECIATION UNDER INCOME FORECAST METHOD.**

(a) GENERAL RULE.—Section 167 (relating to depreciation) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

“(g) DEPRECIATION UNDER INCOME FORECAST METHOD.—

“(1) IN GENERAL.—If the depreciation deduction allowable under this section to any taxpayer with respect to any property is determined under the income forecast method or any similar method—

“(A) the income from the property to be taken into account in determining the depreciation deduction under such method shall be equal to the amount of income earned in connection with the property before the close of the 10th taxable year following the taxable year in which the property was placed in service,

“(B) the adjusted basis of the property shall only include amounts with respect to which the requirements of section 461(h) are satisfied,

“(C) the depreciation deduction under such method for the 10th taxable year beginning after the taxable year in which the property was placed in service shall be equal to the adjusted basis of such property as of the beginning of such 10th taxable year, and

“(D) such taxpayer shall pay (or be entitled to receive) interest computed under the look-back method of paragraph (2) for any recomputation year.

“(2) LOOK-BACK METHOD.—The interest computed under the look-back method of this paragraph for any recomputation year shall be determined by—

“(A) first determining the depreciation deductions under this section with respect to such property which would have been allowable for prior taxable

years if the determination of the amounts so allowable had been made on the basis of the sum of the following (instead of the estimated income from such property)—

“(i) the actual income earned in connection with such property for periods before the close of the recomputation year, and

“(ii) an estimate of the future income to be earned in connection with such property for periods after the recomputation year and before the close of the 10th taxable year following the taxable year in which the property was placed in service,

“(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each such prior taxable year which would result solely from the application of subparagraph (A), and

“(C) then using the adjusted overpayment rate (as defined in section 460(b)(7)), compounded daily, on the overpayment or underpayment determined under subparagraph (B).

For purposes of the preceding sentence, any cost incurred after the property is placed in service (which is not treated as a separate property under paragraph (5)) shall be taken into account by discounting (using the Federal mid-term rate determined under section 1274(d) as of the time such cost is incurred) such cost to its value as of the date the property is placed in service. The taxpayer may elect with respect to any property to have the preceding sentence not apply to such property.

“(3) EXCEPTION FROM LOOK-BACK METHOD.—Paragraph (1)(D) shall not apply with respect to any property which, when placed in service by the taxpayer, had a basis of \$100,000 or less.

“(4) RECOMPUTATION YEAR.—For purposes of this subsection, except as provided in regulations, the term ‘recomputation year’ means, with respect to any property, the 3d and the 10th taxable years beginning after the taxable year in which the property was placed in service, unless the actual income earned in connection with the property for the period before the close of such 3d or 10th taxable year is within 10 percent of the income earned in connection with the property for such period which was taken into account under paragraph (1)(A).

“(5) SPECIAL RULES.—

“(A) CERTAIN COSTS TREATED AS SEPARATE PROPERTY.—For purposes of this subsection, the following costs shall be treated as separate properties:

“(i) Any costs incurred with respect to any property after the 10th taxable year beginning after the taxable year in which the property was placed in service.

“(ii) Any costs incurred after the property is placed in service and before the close of such 10th taxable year if such costs are significant and give rise to a significant increase in the income from the property which was not included in the estimated income from the property.

“(B) SYNDICATION INCOME FROM TELEVISION SERIES.—In the case of property which is an episode in a television series, income from syndicating such series shall not be required to be taken into account under this subsection before the earlier of—

“(i) the 4th taxable year beginning after the date the first episode in such series is placed in service, or

“(ii) the earliest taxable year in which the taxpayer has an arrangement relating to the future syndication of such series.

“(C) SPECIAL RULES FOR FINANCIAL EXPLOITATION OF CHARACTERS, ETC.—For purposes of this subsection, in the case of television and motion picture films, the income from the property shall include income from the exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent that such income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related persons (within the meaning of section 267(b)) to the taxpayer.

“(D) COLLECTION OF INTEREST.—For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under paragraph (1) for any recomputation year shall be treated as an increase in the tax imposed by this chapter for such year.

“(E) DETERMINATIONS.—For purposes of paragraph (2), determinations of the amount of income earned in connection with any property shall be made in the same manner as for purposes of applying the income forecast method; except that any income from the disposition of such property shall be taken into account.

“(F) TREATMENT OF PASS-THRU ENTITIES.—Rules similar to the rules of section 460(b)(4) shall apply for purposes of this subsection.”

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to property placed in service after September 13, 1995.

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any property produced or acquired by the taxpayer pursuant to a written contract which was binding on September 13, 1995, and at all times thereafter before such production or acquisition.

**SEC. 1605. REPEAL OF EXCLUSION FOR PUNITIVE DAMAGES AND FOR DAMAGES NOT ATTRIBUTABLE TO PHYSICAL INJURIES OR SICKNESS.**

(a) IN GENERAL.—Paragraph (2) of section 104(a) (relating to compensation for injuries or sickness) is amended to read as follows:

“(2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness;”.

(b) EMOTIONAL DISTRESS AS SUCH TREATED AS NOT PHYSICAL INJURY OR PHYSICAL SICKNESS.—Section 104(a) is amended by striking the last sentence and inserting the following new sentence: “For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress.”.

(c) APPLICATION OF PRIOR LAW FOR STATES IN WHICH ONLY PUNITIVE DAMAGES MAY BE AWARDED IN WRONGFUL DEATH ACTIONS.—Section 104 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

“(c) APPLICATION OF PRIOR LAW IN CERTAIN CASES.—The phrase ‘(other than punitive damages)’ shall not apply to punitive damages awarded in a civil action—

“(1) which is a wrongful death action, and

“(2) with respect to which applicable State law (as in effect on September 13, 1995 and without regard to any modification after such date) provides, or has been construed to provide by a court of competent jurisdiction pursuant to a decision issued on or before September 13, 1995, that only punitive damages may be awarded in such an action.

This subsection shall cease to apply to any civil action filed on or after the first date on which the applicable State law ceases to provide (or is no longer construed to provide) the treatment described in paragraph (2).”

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to amounts received after June 30, 1996, in taxable years ending after such date.

(2) EXCEPTION.—The amendments made by this section shall not apply to any amount received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

**SEC. 1606. REPEAL OF DIESEL FUEL TAX REBATE TO PURCHASERS OF DIESEL-POWERED AUTOMOBILES AND LIGHT TRUCKS.**

(a) IN GENERAL.—Section 6427 (relating to fuels not used for taxable purposes) is amended by striking subsection (g).

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (3) of section 34(a) is amended to read as follows:

“(3) under section 6427 with respect to fuels used for nontaxable purposes or resold during the taxable year (determined without regard to section 6427(k)).”.

(2) Paragraphs (1) and (2)(A) of section 6427(i) are each amended—

(A) by striking “(g),” and

(B) by striking “(or a qualified diesel powered highway vehicle purchased)” each place it appears.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to vehicles purchased after the date of the enactment of this Act.

## Subtitle G—Technical Corrections

### SEC. 1701. COORDINATION WITH OTHER SUBTITLES.

For purposes of applying the amendments made by any subtitle of this title other than this subtitle, the provisions of this subtitle shall be treated as having been enacted immediately before the provisions of such other subtitles.

### SEC. 1702. AMENDMENTS RELATED TO REVENUE RECONCILIATION ACT OF 1990.

#### (a) AMENDMENTS RELATED TO SUBTITLE A.—

(1) Subparagraph (B) of section 59(j)(3) is amended by striking “section 1(i)(3)(B)” and inserting “section 1(g)(3)(B)”.

(2) Clause (i) of section 151(d)(3)(C) is amended by striking “joint of a return” and inserting “joint return”.

#### (b) AMENDMENTS RELATED TO SUBTITLE B.—

(1) Paragraph (1) of section 11212(e) of the Revenue Reconciliation Act of 1990 is amended by striking “Paragraph (1) of section 6724(d)” and inserting “Subparagraph (B) of section 6724(d)(1)”.

(2)(A) Subparagraph (B) of section 4093(c)(2), as in effect before the amendments made by the Revenue Reconciliation Act of 1993, is amended by inserting before the period “unless such fuel is sold for exclusive use by a State or any political subdivision thereof”.

(B) Paragraph (4) of section 6427(l), as in effect before the amendments made by the Revenue Reconciliation Act of 1993, is amended by inserting before the period “unless such fuel was used by a State or any political subdivision thereof”.

(3) Paragraph (1) of section 6416(b) is amended by striking “chapter 32 or by section 4051” and inserting “chapter 31 or 32”.

(4) Section 7012 is amended—

(A) by striking “production or importation of gasoline” in paragraph (3) and inserting “taxes on gasoline and diesel fuel”, and

(B) by striking paragraph (4) and redesignating paragraphs (5) and (6) as paragraphs (4) and (5), respectively.

(5) Subsection (c) of section 5041 is amended by striking paragraph (6) and by inserting the following new paragraphs:

“(6) CREDIT FOR TRANSFEREE IN BOND.—If—

“(A) wine produced by any person would be eligible for any credit under paragraph (1) if removed by such person during the calendar year,

“(B) wine produced by such person is removed during such calendar year by any other person (hereafter in this paragraph referred to as the ‘transferee’) to whom such wine was transferred in bond and who is liable for the tax imposed by this section with respect to such wine, and

“(C) such producer holds title to such wine at the time of its removal and provides to the transferee such information as is necessary to properly determine the transferee’s credit under this paragraph,

then, the transferee (and not the producer) shall be allowed the credit under paragraph (1) which would be allowed to the producer if the wine removed by the transferee had been removed by the producer on that date.

“(7) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations—

“(A) to prevent the credit provided in this subsection from benefiting any person who produces more than 250,000 wine gallons during a calendar year, and

“(B) to assure proper reduction of such credit for persons producing more than 150,000 wine gallons of wine during a calendar year.”

(6) Paragraph (3) of section 5061(b) is amended to read as follows:

“(3) section 5041(f),”.

(7) Section 5354 is amended by inserting “(taking into account the appropriate amount of credit with respect to such wine under section 5041(c))” after “any one time”.

#### (c) AMENDMENTS RELATED TO SUBTITLE C.—

(1) Paragraph (4) of section 56(g) is amended by redesignating subparagraphs (I) and (J) as subparagraphs (H) and (I), respectively.

(2) Subparagraph (B) of section 6724(d)(1) is amended—

(A) by striking “or” at the end of clause (xii), and

(B) by striking the period at the end of clause (xiii) and inserting “, or”.

(3) Subsection (g) of section 6302 is amended by inserting “, 22,” after “chapters 21”.

(4) The earnings and profits of any insurance company to which section 11305(c)(3) of the Revenue Reconciliation Act of 1990 applies shall be determined without regard to any deduction allowed under such section; except that, for purposes of applying sections 56 and 902, and subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986, such deduction shall be taken into account.

(5) Subparagraph (D) of section 6038A(e)(4) is amended—

(A) by striking “any transaction to which the summons relates” and inserting “any affected taxable year”, and

(B) by adding at the end thereof the following new sentence: “For purposes of this subparagraph, the term ‘affected taxable year’ means any taxable year if the determination of the amount of tax imposed for such taxable year is affected by the treatment of the transaction to which the summons relates.”.

(6) Subparagraph (A) of section 6621(c)(2) is amended by adding at the end thereof the following new flush sentence:

“The preceding sentence shall be applied without regard to any such letter or notice which is withdrawn by the Secretary.”.

(7) Clause (i) of section 6621(c)(2)(B) is amended by striking “this subtitle” and inserting “this title”.

(d) AMENDMENTS RELATED TO SUBTITLE D.—

(1) Notwithstanding section 11402(c) of the Revenue Reconciliation Act of 1990, the amendment made by section 11402(b)(1) of such Act shall apply to taxable years ending after December 31, 1989.

(2) Clause (ii) of section 143(m)(4)(C) is amended—

(A) by striking “any month of the 10-year period” and inserting “any year of the 4-year period”,

(B) by striking “succeeding months” and inserting “succeeding years”, and

(C) by striking “over the remainder of such period (or, if lesser, 5 years)” and inserting “to zero over the succeeding 5 years”.

(e) AMENDMENTS RELATED TO SUBTITLE E.—

(1)(A) Clause (ii) of section 56(d)(1)(B) is amended to read as follows:

“(ii) appropriate adjustments in the application of section 172(b)(2) shall be made to take into account the limitation of subparagraph (A).”

(B) For purposes of applying sections 56(g)(1) and 56(g)(3) of the Internal Revenue Code of 1986 with respect to taxable years beginning in 1991 and 1992, the reference in such sections to the alternative tax net operating loss deduction shall be treated as including a reference to the deduction under section 56(h) of such Code as in effect before the amendments made by section 1915 of the Energy Policy Act of 1992.

(2) Clause (i) of section 613A(c)(3)(A) is amended by striking “the table contained in”.

(3) Section 6501 is amended—

(A) by striking subsection (m) (relating to deficiency attributable to election under section 44B) and by redesignating subsections (n) and (o) as subsections (m) and (n), respectively, and

(B) by striking “section 40(f) or 51(j)” in subsection (m) (as redesignated by subparagraph (A)) and inserting “section 40(f), 43, or 51(j)”.

(4) Subparagraph (C) of section 38(c)(2) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) is amended by inserting before the period at the end of the first sentence the following: “and without regard to the deduction under section 56(h)”.

(5) The amendment made by section 1913(b)(2)(C)(i) of the Energy Policy Act of 1992 shall apply to taxable years beginning after December 31, 1990.

(f) AMENDMENTS RELATED TO SUBTITLE F.—

(1)(A) Section 2701(a)(3) is amended by adding at the end thereof the following new subparagraph:

“(C) VALUATION OF QUALIFIED PAYMENTS WHERE NO LIQUIDATION, ETC. RIGHTS.—In the case of an applicable retained interest which is described in subparagraph (B)(i) but not subparagraph (B)(ii), the value of the distribution right shall be determined without regard to this section.”

(B) Section 2701(a)(3)(B) is amended by inserting “CERTAIN” before “QUALIFIED” in the heading thereof.

(C) Sections 2701 (d)(1) and (d)(4) are each amended by striking “subsection (a)(3)(B)” and inserting “subsection (a)(3) (B) or (C)”.

(2) Clause (i) of section 2701(a)(4)(B) is amended by inserting “(or, to the extent provided in regulations, the rights as to either income or capital)” after “income and capital”.

(3)(A) Section 2701(b)(2) is amended by adding at the end thereof the following new subparagraph:

“(C) APPLICABLE FAMILY MEMBER.—For purposes of this subsection, the term ‘applicable family member’ includes any lineal descendant of any parent of the transferor or the transferor’s spouse.”

(B) Section 2701(e)(3) is amended—

(i) by striking subparagraph (B), and

(ii) by striking so much of paragraph (3) as precedes “shall be treated as holding” and inserting:

“(3) ATTRIBUTION OF INDIRECT HOLDINGS AND TRANSFERS.—An individual”.

(C) Section 2704(c)(3) is amended by striking “section 2701(e)(3)(A)” and inserting “section 2701(e)(3)”.

(4) Clause (i) of section 2701(c)(1)(B) is amended to read as follows:

“(i) a right to distributions with respect to any interest which is junior to the rights of the transferred interest,”.

(5)(A) Clause (i) of section 2701(c)(3)(C) is amended to read as follows:

“(i) IN GENERAL.—Payments under any interest held by a transferor which (without regard to this subparagraph) are qualified payments shall be treated as qualified payments unless the transferor elects not to treat such payments as qualified payments. Payments described in the preceding sentence which are held by an applicable family member shall be treated as qualified payments only if such member elects to treat such payments as qualified payments.”

(B) The first sentence of section 2701(c)(3)(C)(ii) is amended to read as follows: “A transferor or applicable family member holding any distribution right which (without regard to this subparagraph) is not a qualified payment may elect to treat such right as a qualified payment, to be paid in the amounts and at the times specified in such election.”.

(C) The time for making an election under the second sentence of section 2701(c)(3)(C)(i) of the Internal Revenue Code of 1986 (as amended by subparagraph (A)) shall not expire before the due date (including extensions) for filing the transferor’s return of the tax imposed by section 2501 of such Code for the first calendar year ending after the date of enactment.

(6) Section 2701(d)(3)(A)(iii) is amended by striking “the period ending on the date of”.

(7) Subclause (I) of section 2701(d)(3)(B)(ii) is amended by inserting “or the exclusion under section 2503(b),” after “section 2523,”.

(8) Section 2701(e)(5) is amended—

(A) by striking “such contribution to capital or such redemption, recapitalization, or other change” in subparagraph (A) and inserting “such transaction”, and

(B) by striking “the transfer” in subparagraph (B) and inserting “such transaction”.

(9) Section 2701(d)(4) is amended by adding at the end thereof the following new subparagraph:

“(C) TRANSFER TO TRANSFERORS.—In the case of a taxable event described in paragraph (3)(A)(ii) involving a transfer of an applicable retained interest from an applicable family member to a transferor, this subsection shall continue to apply to the transferor during any period the transferor holds such interest.”

(10) Section 2701(e)(6) is amended by inserting “or to reflect the application of subsection (d)” before the period at the end thereof.

(11)(A) Section 2702(a)(3)(A) is amended—

(i) by striking “to the extent” and inserting “if” in clause (i),

(ii) by striking “or” at the end of clause (i),

(iii) by striking the period at the end of clause (ii) and inserting “, or”, and

(iv) by adding at the end thereof the following new clause:

“(iii) to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section.”

(B)(i) Section 2702(a)(3) is amended by striking “incomplete transfer” each place it appears and inserting “incomplete gift”.

(ii) The heading for section 2702(a)(3)(B) is amended by striking “INCOMPLETE TRANSFER” and inserting “INCOMPLETE GIFT”.

(g) AMENDMENTS RELATED TO SUBTITLE G.—

(1)(A) Subsection (a) of section 1248 is amended—



(i) by striking “, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock” in paragraph (1), and

(ii) by adding at the end thereof the following new sentence: “For purposes of this section, a United States person shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such person is treated as realizing gain from the sale or exchange of such stock.”.

(B) Paragraph (1) of section 1248(e) is amended by striking “, or receives a distribution from a domestic corporation which, under section 302 or 331, is treated as an exchange of stock”.

(C) Subparagraph (B) of section 1248(f)(1) is amended by striking “or 361(c)(1)” and inserting “355(c)(1), or 361(c)(1)”.

(D) Paragraph (1) of section 1248(i) is amended to read as follows:

“(1) IN GENERAL.—If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, such 10-percent corporate shareholder shall recognize gain in the same manner as if the stock of the foreign corporation received in such exchange had been—

“(A) issued to the 10-percent corporate shareholder, and

“(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).

The amount of gain recognized by such 10-percent corporate shareholder under the preceding sentence shall not exceed the amount treated as a dividend under this section.”

(2) Section 897 is amended by striking subsection (f).

(3) Paragraph (13) of section 4975(d) is amended by striking “section 408(b)” and inserting “section 408(b)(12)”.

(4) Clause (iii) of section 56(g)(4)(D) is amended by inserting “, but only with respect to taxable years beginning after December 31, 1989” before the period at the end thereof.

(5)(A) Paragraph (11) of section 11701(a) of the Revenue Reconciliation Act of 1990 (and the amendment made by such paragraph) are hereby repealed, and section 7108(r)(2) of the Revenue Reconciliation Act of 1989 shall be applied as if such paragraph (and amendment) had never been enacted.

(B) Subparagraph (A) shall not apply to any building if the owner of such building establishes to the satisfaction of the Secretary of the Treasury or his delegate that such owner reasonably relied on the amendment made by such paragraph (11).

(h) AMENDMENTS RELATED TO SUBTITLE H.—

(1)(A) Clause (vi) of section 168(e)(3)(B) is amended by striking “or” at the end of subclause (I), by striking the period at the end of subclause (II) and inserting “, or”, and by adding at the end thereof the following new subclause:

“(III) is described in section 48(l)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).”

(B) Subparagraph (B) of section 168(e)(3) (relating to 5-year property) is amended by adding at the end the following flush sentence:

“Nothing in any provision of law shall be construed to treat property as not being described in clause (vi)(I) (or the corresponding provisions of prior law) by reason of being public utility property (within the meaning of section 48(a)(3)).”

(C) Subparagraph (K) of section 168(g)(4) is amended by striking “section 48(a)(3)(A)(iii)” and inserting “section 48(l)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)”.

(2) Clause (ii) of section 172(b)(1)(E) is amended by striking “subsection (m)” and inserting “subsection (h)”.

(3) Sections 805(a)(4)(E), 832(b)(5)(C)(ii)(II), and 832(b)(5)(D)(ii)(II) are each amended by striking “243(b)(5)” and inserting “243(b)(2)”.

(4) Subparagraph (A) of section 243(b)(3) is amended by inserting “of” after “In the case”.

(5) The subsection heading for subsection (a) of section 280F is amended by striking “INVESTMENT TAX CREDIT AND”.

(6) Clause (i) of section 1504(c)(2)(B) is amended by inserting “section” before “243(b)(2)”.

(7) Paragraph (3) of section 341(f) is amended by striking “351, 361, 371(a), or 374(a)” and inserting “351, or 361”.

(8) Paragraph (2) of section 243(b) is amended to read as follows:

“(2) AFFILIATED GROUP.—For purposes of this subsection:

“(A) IN GENERAL.—The term ‘affiliated group’ has the meaning given such term by section 1504(a), except that for such purposes sections 1504(b)(2), 1504(b)(4), and 1504(c) shall not apply.

“(B) GROUP MUST BE CONSISTENT IN FOREIGN TAX TREATMENT.—The requirements of paragraph (1)(A) shall not be treated as being met with respect to any dividend received by a corporation if, for any taxable year which includes the day on which such dividend is received—

“(i) 1 or more members of the affiliated group referred to in paragraph (1)(A) choose to any extent to take the benefits of section 901, and

“(ii) 1 or more other members of such group claim to any extent a deduction for taxes otherwise creditable under section 901.”

(9) The amendment made by section 11813(b)(17) of the Revenue Reconciliation Act of 1990 shall be applied as if the material stricken by such amendment included the closing parenthesis after “section 48(a)(5)”.

(10) Paragraph (1) of section 179(d) is amended by striking “in a trade or business” and inserting “a trade or business”.

(11) Subparagraph (E) of section 50(a)(2) is amended by striking “section 48(a)(5)(A)” and inserting “section 48(a)(5)”.

(12) The amendment made by section 11801(c)(9)(G)(ii) of the Revenue Reconciliation Act of 1990 shall be applied as if it struck “Section 422A(c)(2)” and inserted “Section 422(c)(2)”.

(13) Subparagraph (B) of section 424(c)(3) is amended by striking “a qualified stock option, an incentive stock option, an option granted under an employee stock purchase plan, or a restricted stock option” and inserting “an incentive stock option or an option granted under an employee stock purchase plan”.

(14) Subparagraph (E) of section 1367(a)(2) is amended by striking “section 613A(c)(13)(B)” and inserting “section 613A(c)(11)(B)”.

(15) Subparagraph (B) of section 460(e)(6) is amended by striking “section 167(k)” and inserting “section 168(e)(2)(A)(ii)”.

(16) Subparagraph (C) of section 172(h)(4) is amended by striking “subsection (b)(1)(M)” and inserting “subsection (b)(1)(E)”.

(17) Section 6503 is amended—

(A) by redesignating the subsection relating to extension in case of certain summonses as subsection (j), and

(B) by redesignating the subsection relating to cross references as subsection (k).

(18) Paragraph (4) of section 1250(e) is hereby repealed.

(i) EFFECTIVE DATE.—Except as otherwise expressly provided—

(1) the amendments made by this section shall be treated as amendments to the Internal Revenue Code of 1986 as amended by the Revenue Reconciliation Act of 1993; and

(2) any amendment made by this section shall apply to periods before the date of the enactment of this section in the same manner as if it had been included in the provision of the Revenue Reconciliation Act of 1990 to which such amendment relates.

#### SEC. 1703. AMENDMENTS RELATED TO REVENUE RECONCILIATION ACT OF 1993.

(a) AMENDMENT RELATED TO SECTION 13114.—Paragraph (2) of section 1044(c) is amended to read as follows:

“(2) PURCHASE.—The taxpayer shall be considered to have purchased any property if, but for subsection (d), the unadjusted basis of such property would be its cost within the meaning of section 1012.”

(b) AMENDMENTS RELATED TO SECTION 13142.—

(1) Subparagraph (B) of section 13142(b)(6) of the Revenue Reconciliation Act of 1993 is amended to read as follows:

“(B) FULL-TIME STUDENTS, WAIVER AUTHORITY, AND PROHIBITED DISCRIMINATION.—The amendments made by paragraphs (2), (3), and (4) shall take effect on the date of the enactment of this Act.”

(2) Subparagraph (C) of section 13142(b)(6) of such Act is amended by striking “paragraph (2)” and inserting “paragraph (5)”.

(c) AMENDMENT RELATED TO SECTION 13161.—

(1) IN GENERAL.—Subsection (e) of section 4001 (relating to inflation adjustment) is amended to read as follows:

“(e) INFLATION ADJUSTMENT.—

“(1) IN GENERAL.—The \$30,000 amount in subsection (a) and section 4003(a) shall be increased by an amount equal to—

“(A) \$30,000, multiplied by

- “(B) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the vehicle is sold, determined by substituting ‘calendar year 1990’ for ‘calendar year 1992’ in subparagraph (B) thereof.
- “(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of \$2,000, such amount shall be rounded to the next lowest multiple of \$2,000.”
- (2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect on the date of the enactment of this Act.
- (d) AMENDMENT RELATED TO SECTION 13201.—Clause (ii) of section 135(b)(2)(B) is amended by inserting before the period at the end thereof the following: “, determined by substituting ‘calendar year 1989’ for ‘calendar year 1992’ in subparagraph (B) thereof”.
- (e) AMENDMENTS RELATED TO SECTION 13203.—Subsection (a) of section 59 is amended—
- (1) by striking “the amount determined under section 55(b)(1)(A)” in paragraph (1)(A) and (2)(A)(i) and inserting “the pre-credit tentative minimum tax”,
  - (2) by striking “specified in section 55(b)(1)(A)” in paragraph (1)(C) and inserting “specified in subparagraph (A)(i) or (B)(i) of section 55(b)(1) (whichever applies)”,
  - (3) by striking “which would be determined under section 55(b)(1)(A)” in paragraph (2)(A)(ii) and inserting “which would be the pre-credit tentative minimum tax”, and
  - (4) by adding at the end thereof the following new paragraph:
 

“(3) PRE-CREDIT TENTATIVE MINIMUM TAX.—For purposes of this subsection, the term ‘pre-credit tentative minimum tax’ means—

“(A) in the case of a taxpayer other than a corporation, the amount determined under the first sentence of section 55(b)(1)(A)(i), or

“(B) in the case of a corporation, the amount determined under section 55(b)(1)(B)(i).”
- (f) AMENDMENT RELATED TO SECTION 13221.—Sections 1201(a) and 1561(a) are each amended by striking “last sentence” each place it appears and inserting “last 2 sentences”.
- (g) AMENDMENTS RELATED TO SECTION 13222.—
- (1) Subparagraph (B) of section 6033(e)(1) is amended by adding at the end thereof the following new clause:
 

“(iii) COORDINATION WITH SECTION 527(f).—This subsection shall not apply to any amount on which tax is imposed by reason of section 527(f).”
  - (2) Clause (i) of section 6033(e)(1)(B) is amended by striking “this subtitle” and inserting “section 501”.
- (h) AMENDMENT RELATED TO SECTION 13225.—Paragraph (3) of section 6655(g) is amended by striking all that follows “3rd month” in the sentence following subparagraph (C) and inserting “, subsection (e)(2)(A) shall be applied by substituting ‘2 months’ for ‘3 months’ in clause (i)(I), the election under clause (i) of subsection (e)(2)(C) may be made separately for each installment, and clause (ii) of subsection (e)(2)(C) shall not apply.”.
- (i) AMENDMENTS RELATED TO SECTION 13231.—
- (1) Subparagraph (G) of section 904(d)(3) is amended by striking “section 951(a)(1)(B)” and inserting “subparagraph (B) or (C) of section 951(a)(1)”.
  - (2) Paragraph (1) of section 956A(b) is amended to read as follows:
 

“(1) the amount (not including a deficit) referred to in section 316(a)(1) to the extent such amount was accumulated in prior taxable years beginning after September 30, 1993, and”.
  - (3) Subsection (f) of section 956A is amended by inserting before the period at the end thereof: “and regulations coordinating the provisions of subsections (c)(3)(A) and (d)”.
  - (4) Subsection (b) of section 958 is amended by striking “956(b)(2)” each place it appears and inserting “956(c)(2)”.
  - (5)(A) Subparagraph (A) of section 1297(d)(2) is amended by striking “The adjusted basis of any asset” and inserting “The amount taken into account under section 1296(a)(2) with respect to any asset”.
  - (B) The paragraph heading of paragraph (2) of section 1297(d) is amended to read as follows:
 

“(2) AMOUNT TAKEN INTO ACCOUNT.—”.
  - (6) Subsection (e) of section 1297 is amended by inserting “For purposes of this part—” after the subsection heading.
- (j) AMENDMENT RELATED TO SECTION 13241.—Subparagraph (B) of section 40(e)(1) is amended to read as follows:

- “(B) for any period before January 1, 2001, during which the rates of tax under section 4081(a)(2)(A) are 4.3 cents per gallon.”
- (k) AMENDMENT RELATED TO SECTION 13261.—Clause (iii) of section 13261(g)(2)(A) of the Revenue Reconciliation Act of 1993 is amended by striking “by the taxpayer” and inserting “by the taxpayer or a related person”.
- (l) AMENDMENT RELATED TO SECTION 13301.—Subparagraph (B) of section 1397B(d)(5) is amended by striking “preceding”.

(m) CLERICAL AMENDMENTS.—

- (1) Subsection (d) of section 39 is amended—
- (A) by striking “45” in the heading of paragraph (5) and inserting “45A”, and
- (B) by striking “45” in the heading of paragraph (6) and inserting “45B”.
- (2) Subparagraph (A) of section 108(d)(9) is amended by striking “paragraph (3)(B)” and inserting “paragraph (3)(C)”.
- (3) Subparagraph (C) of section 143(d)(2) is amended by striking the period at the end thereof and inserting a comma.
- (4) Clause (ii) of section 163(j)(6)(E) is amended by striking “which is a” and inserting “which is”.
- (5) Subparagraph (A) of section 1017(b)(4) is amended by striking “subsection (b)(2)(D)” and inserting “subsection (b)(2)(E)”.
- (6) So much of section 1245(a)(3) as precedes subparagraph (A) thereof is amended to read as follows:
- “(3) SECTION 1245 PROPERTY.—For purposes of this section, the term ‘section 1245 property’ means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either—”
- (7) Paragraph (2) of section 1394(e) is amended—
- (A) by striking “(i)” and inserting “(A)”, and
- (B) by striking “(ii)” and inserting “(B)”.
- (8) Subsection (m) of section 6501 (as redesignated by section 1602) is amended by striking “or 51(j)” and inserting “45B, or 51(j)”.
- (9)(A) The section 6714 added by section 13242(b)(1) of the Revenue Reconciliation Act of 1993 is hereby redesignated as section 6715.
- (B) The table of sections for part I of subchapter B of chapter 68 is amended by striking “6714” in the item added by such section 13242(b)(2) of such Act and inserting “6715”.
- (10) Paragraph (2) of section 9502(b) is amended by inserting “and before” after “1982”.
- (11) Subsection (a)(3) of section 13206 of the Revenue Reconciliation Act of 1993 is amended by striking “this section” and inserting “this subsection”.
- (12) Paragraph (1) of section 13215(c) of the Revenue Reconciliation Act of 1993 is amended by striking “Public Law 92–21” and inserting “Public Law 98–21”.
- (13) Paragraph (2) of section 13311(e) of the Revenue Reconciliation Act of 1993 is amended by striking “section 1393(a)(3)” and inserting “section 1393(a)(2)”.
- (14) Subparagraph (B) of section 117(d)(2) is amended by striking “section 132(f)” and inserting “section 132(h)”.
- (n) EFFECTIVE DATE.—Any amendment made by this section shall take effect as if included in the provision of the Revenue Reconciliation Act of 1993 to which such amendment relates.

**SEC. 1704. MISCELLANEOUS PROVISIONS.**

(a) APPLICATION OF AMENDMENTS MADE BY TITLE XII OF OMNIBUS BUDGET RECONCILIATION ACT OF 1990.—Except as otherwise expressly provided, whenever in title XII of the Omnibus Budget Reconciliation Act of 1990 an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(b) TREATMENT OF CERTAIN AMOUNTS UNDER HEDGE BOND RULES.—

(1) Clause (iii) of section 149(g)(3)(B) is amended to read as follows:

“(iii) AMOUNTS HELD PENDING REINVESTMENT OR REDEMPTION.—Amounts held for not more than 30 days pending reinvestment or bond redemption shall be treated as invested in bonds described in clause (i).”

(2) The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 7651 of the Omnibus Budget Reconciliation Act of 1989.

## (c) TREATMENT OF CERTAIN DISTRIBUTIONS UNDER SECTION 1445.—

(1) IN GENERAL.—Paragraph (3) of section 1445(e) is amended by adding at the end thereof the following new sentence: “Rules similar to the rules of the preceding provisions of this paragraph shall apply in the case of any distribution to which section 301 applies and which is not made out of the earnings and profits of such a domestic corporation.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to distributions after the date of the enactment of this Act.

## (d) TREATMENT OF CERTAIN CREDITS UNDER SECTION 469.—

(1) IN GENERAL.—Subparagraph (B) of section 469(c)(3) is amended by adding at the end thereof the following new sentence: “If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1986.

## (e) TREATMENT OF DISPOSITIONS UNDER PASSIVE LOSS RULES.—

(1) IN GENERAL.—Subparagraph (A) of section 469(g)(1) is amended to read as follows:

“(A) IN GENERAL.—If all gain or loss realized on such disposition is recognized, the excess of—

“(i) any loss from such activity for such taxable year (determined after the application of subsection (b)), over

“(ii) any net income or gain for such taxable year from all other passive activities (determined after the application of subsection (b)),

shall be treated as a loss which is not from a passive activity.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1986.

## (f) MISCELLANEOUS AMENDMENTS TO FOREIGN PROVISIONS.—

(1) COORDINATION OF UNIFIED ESTATE TAX CREDIT WITH TREATIES.—Subparagraph (A) of section 2102(c)(3) is amended by adding at the end thereof the following new sentence: “For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.”

## (2) TREATMENT OF CERTAIN INTEREST PAID TO RELATED PERSON.—

(A) Subparagraph (B) of section 163(j)(1) is amended by inserting before the period at the end thereof the following: “(and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated)”.

(B) Subsection (j) of section 163 is amended by redesignating paragraph (7) as paragraph (8) and by inserting after paragraph (6) the following new paragraph:

“(7) COORDINATION WITH PASSIVE LOSS RULES, ETC.—This subsection shall be applied before sections 465 and 469.”

(C) The amendments made by this paragraph shall apply as if included in the amendments made by section 7210(a) of the Revenue Reconciliation Act of 1989.

## (3) TREATMENT OF INTEREST ALLOCABLE TO EFFECTIVELY CONNECTED INCOME.—

## (A) IN GENERAL.—

(i) Subparagraph (B) of section 884(f)(1) is amended by striking “to the extent” and all that follows down through “subparagraph (A)” and inserting “to the extent that the allocable interest exceeds the interest described in subparagraph (A)”.

(ii) The second sentence of section 884(f)(1) is amended by striking “reasonably expected” and all that follows down through the period at the end thereof and inserting “reasonably expected to be allocable interest.”

(iii) Paragraph (2) of section 884(f) is amended to read as follows:

“(2) ALLOCABLE INTEREST.—For purposes of this subsection, the term ‘allocable interest’ means any interest which is allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.”

(B) EFFECTIVE DATE.—The amendments made by subparagraph (A) shall take effect as if included in the amendments made by section 1241(a) of the Tax Reform Act of 1986.

(4) CLARIFICATION OF SOURCE RULE.—

(A) IN GENERAL.—Paragraph (2) of section 865(b) is amended by striking “863(b)” and inserting “863”.

(B) EFFECTIVE DATE.—The amendment made by subparagraph (A) shall take effect as if included in the amendments made by section 1211 of the Tax Reform Act of 1986.

(5) REPEAL OF OBSOLETE PROVISIONS.—

(A) Paragraph (1) of section 6038(a) is amended by striking “, and” at the end of subparagraph (E) and inserting a period, and by striking subparagraph (F).

(B) Subsection (b) of section 6038A is amended by adding “and” at the end of paragraph (2), by striking “, and” at the end of paragraph (3) and inserting a period, and by striking paragraph (4).

(g) TREATMENT OF ASSIGNMENT OF INTEREST IN CERTAIN BOND-FINANCED FACILITIES.—

(1) IN GENERAL.—Subparagraph (A) of section 1317(3) of the Tax Reform Act of 1986 is amended by adding at the end thereof the following new sentence: “A facility shall not fail to be treated as described in this subparagraph by reason of an assignment (or an agreement to an assignment) by the governmental unit on whose behalf the bonds are issued of any part of its interest in the property financed by such bonds to another governmental unit.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in such section 1317 on the date of the enactment of the Tax Reform Act of 1986.

(h) CLARIFICATION OF TREATMENT OF MEDICARE ENTITLEMENT UNDER COBRA PROVISIONS.—

(1) IN GENERAL.—

(A) Subclause (V) of section 4980B(f)(2)(B)(i) is amended to read as follows:

“(V) MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.—In the case of a qualifying event described in paragraph (3)(B) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than the covered employee shall not terminate under this clause before the close of the 36-month period beginning on the date the covered employee became so entitled.”

(B) Clause (v) of section 602(2)(A) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

“(v) MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.—In the case of a qualifying event described in section 603(2) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than the covered employee shall not terminate under this subparagraph before the close of the 36-month period beginning on the date the covered employee became so entitled.”

(C) Clause (iv) of section 2202(2)(A) of the Public Health Service Act is amended to read as follows:

“(iv) MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.—In the case of a qualifying event described in section 2203(2) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than the covered employee shall not terminate under this subparagraph before the close of the 36-month period beginning on the date the covered employee became so entitled.”

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to plan years beginning after December 31, 1989.

(i) TREATMENT OF CERTAIN REMIC INCLUSIONS.—

(1) IN GENERAL.—Subsection (a) of section 860E is amended by adding at the end thereof the following new paragraph:

“(6) COORDINATION WITH MINIMUM TAX.—For purposes of part VI of subchapter A of this chapter—

“(A) the reference in section 55(b)(2) to taxable income shall be treated as a reference to taxable income determined without regard to this subsection,

“(B) the alternative minimum taxable income of any holder of a residual interest in a REMIC for any taxable year shall in no event be less than the excess inclusion for such taxable year, and

“(C) any excess inclusion shall be disregarded for purposes of computing the alternative tax net operating loss deduction.

The preceding sentence shall not apply to any organization to which section 593 applies, except to the extent provided in regulations prescribed by the Secretary under paragraph (2).”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 671 of the Tax Reform Act of 1986 unless the taxpayer elects to apply such amendment only to taxable years beginning after the date of the enactment of this Act.

(j) EXEMPTION FROM HARBOR MAINTENANCE TAX FOR CERTAIN PASSENGERS.—

(1) IN GENERAL.—Subparagraph (D) of section 4462(b)(1) (relating to special rule for Alaska, Hawaii, and possessions) is amended by inserting before the period the following: “, or passengers transported on United States flag vessels operating solely within the State waters of Alaska or Hawaii and adjacent international waters”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 1402(a) of the Harbor Maintenance Revenue Act of 1986.

(k) AMENDMENTS RELATED TO REVENUE PROVISIONS OF ENERGY POLICY ACT OF 1992.—

(1) Effective with respect to taxable years beginning after December 31, 1990, subclause (II) of section 53(d)(1)(B)(iv) is amended to read as follows:

“(II) the adjusted net minimum tax for any taxable year is the amount of the net minimum tax for such year increased in the manner provided in clause (iii).”

(2) Subsection (g) of section 179A is redesignated as subsection (f).

(3) Subparagraph (E) of section 6724(d)(3) is amended by striking “section 6109(f)” and inserting “section 6109(h)”.

(4)(A) Subsection (d) of section 30 is amended—

(i) by inserting “(determined without regard to subsection (b)(3))” before the period at the end of paragraph (1) thereof, and

(ii) by adding at the end thereof the following new paragraph:

“(4) ELECTION TO NOT TAKE CREDIT.—No credit shall be allowed under subsection (a) for any vehicle if the taxpayer elects to not have this section apply to such vehicle.”

(B) Subsection (m) of section 6501 (as redesignated by section 1602) is amended by striking “section 40(f)” and inserting “section 30(d)(4), 40(f)”.

(5) Subclause (III) of section 501(c)(21)(D)(ii) is amended by striking “section 101(6)” and inserting “section 101(7)” and by striking “1752(6)” and inserting “1752(7)”.

(6) Paragraph (1) of section 1917(b) of the Energy Policy Act of 1992 shall be applied as if “at a rate” appeared instead of “at the rate” in the material proposed to be stricken.

(7) Paragraph (2) of section 1921(b) of the Energy Policy Act of 1992 shall be applied as if a comma appeared after “(2)” in the material proposed to be stricken.

(8) Subsection (a) of section 1937 of the Energy Policy Act of 1992 shall be applied as if “Subpart B” appeared instead of “Subpart C”.

(l) TREATMENT OF QUALIFIED FOOTBALL COACHES PLAN.—

(1) IN GENERAL.—Subparagraph (F) of section 3(37) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(37)(F)) is amended by redesignating clause (ii) as clause (iii) and by inserting after clause (i) the following new clause:

“(ii) For purposes of the Internal Revenue Code of 1986—

“(I) clause (i) shall apply, and

“(II) a qualified football coaches plan shall be treated as a multiemployer collectively bargained plan.”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to years beginning after December 22, 1987.

(m) DETERMINATION OF UNRECOVERED INVESTMENT IN ANNUITY CONTRACT.—

(1) IN GENERAL.—Subparagraph (A) of section 72(b)(4) is amended by inserting “(determined without regard to subsection (c)(2))” after “contract”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 1122(c) of the Tax Reform Act of 1986.

(n) MODIFICATIONS TO ELECTION TO INCLUDE CHILD'S INCOME ON PARENT'S RETURN.—

(1) ELIGIBILITY FOR ELECTION.—Clause (ii) of section 1(g)(7)(A) (relating to election to include certain unearned income of child on parent's return) is amended to read as follows:

“(ii) such gross income is more than the amount described in paragraph (4)(A)(ii)(I) and less than 10 times the amount so described,”.

(2) COMPUTATION OF TAX.—Subparagraph (B) of section 1(g)(7) (relating to income included on parent's return) is amended—

(A) by striking “\$1,000” in clause (i) and inserting “twice the amount described in paragraph (4)(A)(ii)(I)”, and

(B) by amending subclause (II) of clause (ii) to read as follows:

“(II) for each such child, 15 percent of the lesser of the amount described in paragraph (4)(A)(ii)(I) or the excess of the gross income of such child over the amount so described, and”.

(3) MINIMUM TAX.—Subparagraph (B) of section 59(j)(1) is amended by striking “\$1,000” and inserting “twice the amount in effect for the taxable year under section 63(c)(5)(A)”.

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 1995.

(o) TREATMENT OF CERTAIN VETERANS' REEMPLOYMENT RIGHTS.—

(1) IN GENERAL.—Section 414 is amended by adding at the end the following new subsection:

“(u) SPECIAL RULES RELATING TO VETERANS' REEMPLOYMENT RIGHTS UNDER USERRA.—

“(1) TREATMENT OF CERTAIN CONTRIBUTIONS MADE PURSUANT TO VETERANS' REEMPLOYMENT RIGHTS.—If any contribution is made by an employer or an employee under an individual account plan with respect to an employee, or by an employee to a defined benefit plan that provides for employee contributions, and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, then—

“(A) such contribution shall not be subject to any otherwise applicable limitation contained in section 402(g), 402(h), 403(b), 404(a), 404(h), 408, 415, or 457, and shall not be taken into account in applying such limitations to other contributions or benefits under such plan or any other plan, with respect to the year in which the contribution is made,

“(B) such contribution shall be subject to the limitations referred to in subparagraph (A) with respect to the year to which the contribution relates (in accordance with rules prescribed by the Secretary), and

“(C) such plan shall not be treated as failing to meet the requirements of section 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 401(m), 403(b)(12), 408(k)(3), 408(k)(6), 408(p), 410(b), or 416 by reason of the making of (or the right to make) such contribution.

For purposes of the preceding sentence, any elective deferral or employee contribution made under paragraph (2) shall be treated as required by reason of the employee's rights under such chapter 43.

“(2) REEMPLOYMENT RIGHTS UNDER USERRA WITH RESPECT TO ELECTIVE DEFERRALS.—

“(A) IN GENERAL.—For purposes of this subchapter and section 457, if an employee is entitled to the benefits of chapter 43 of title 38, United States Code, with respect to any plan which provides for elective deferrals, the employer sponsoring the plan shall be treated as meeting the requirements of such chapter 43 with respect to such elective deferrals only if such employer—

“(i) permits such employee to make additional elective deferrals under such plan (in the amount determined under subparagraph (B) or such lesser amount as is elected by the employee) during the period which begins on the date of the reemployment of such employee with such employer and has the same length as the lesser of—

“(I) the product of 3 and the period of qualified military service which resulted in such rights, and

“(II) 5 years, and

“(ii) makes a matching contribution with respect to any additional elective deferral made pursuant to clause (i) which would have been re-



quired had such deferral actually been made during the period of such qualified military service.

“(B) AMOUNT OF MAKEUP REQUIRED.—The amount determined under this subparagraph with respect to any plan is the maximum amount of the elective deferrals that the individual would have been permitted to make under the plan in accordance with the limitations referred to in paragraph (1)(A) during the period of qualified military service if the individual had continued to be employed by the employer during such period and received compensation as determined under paragraph (7). Proper adjustment shall be made to the amount determined under the preceding sentence for any elective deferrals actually made during the period of such qualified military service.

“(C) ELECTIVE DEFERRAL.—For purposes of this paragraph, the term ‘elective deferral’ has the meaning given such term by section 402(g)(3); except that such term shall include any deferral of compensation under an eligible deferred compensation plan (as defined in section 457(b)).

“(D) AFTER-TAX EMPLOYEE CONTRIBUTIONS.—References in subparagraphs (A) and (B) to elective deferrals shall be treated as including references to employee contributions.

“(3) CERTAIN RETROACTIVE ADJUSTMENTS NOT REQUIRED.—For purposes of this subchapter and subchapter E, no provision of chapter 43 of title 38, United States Code, shall be construed as requiring—

“(A) any crediting of earnings to an employee with respect to any contribution before such contribution is actually made, or

“(B) any allocation of any forfeiture with respect to the period of qualified military service.

“(4) LOAN REPAYMENT SUSPENSIONS PERMITTED.—If any plan suspends the obligation to repay any loan made to an employee from such plan for any part of any period during which such employee is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code), whether or not qualified military service, such suspension shall not be taken into account for purposes of section 72(p), 401(a), or 4975(d)(1).

“(5) QUALIFIED MILITARY SERVICE.—For purposes of this subsection, the term ‘qualified military service’ means any service in the uniformed services (as defined in chapter 43 of title 38, United States Code) by any individual if such individual is entitled to reemployment rights under such chapter with respect to such service.

“(6) INDIVIDUAL ACCOUNT PLAN.—For purposes of this subsection, the term ‘individual account plan’ means any defined contribution plan (including any tax-sheltered annuity plan under section 403(b), any simplified employee pension under section 408(k), any qualified salary reduction arrangement under section 408(p), and any eligible deferred compensation plan (as defined in section 457(b))).

“(7) COMPENSATION.—For purposes of sections 403(b)(3), 415(c)(3), and 457(e)(5), an employee who is in qualified military service shall be treated as receiving compensation from the employer during such period of qualified military service equal to—

“(A) the compensation the employee would have received during such period if the employee were not in qualified military service, determined based on the rate of pay the employee would have received from the employer but for absence during the period of qualified military service, or

“(B) if the compensation the employee would have received during such period was not reasonably certain, the employee’s average compensation from the employer during the 12-month period immediately preceding the qualified military service (or, if shorter, the period of employment immediately preceding the qualified military service).

“(8) USERRA REQUIREMENTS FOR QUALIFIED RETIREMENT PLANS.—For purposes of this subchapter and section 457, an employer sponsoring a retirement plan shall be treated as meeting the requirements of chapter 43 of title 38, United States Code, only if each of the following requirements is met:

“(A) An individual reemployed under such chapter is treated with respect to such plan as not having incurred a break in service with the employer maintaining the plan by reason of such individual’s period of qualified military service.

“(B) Each period of qualified military service served by an individual is, upon reemployment under such chapter, deemed with respect to such plan to constitute service with the employer maintaining the plan for the purpose of determining the nonforfeatability of the individual’s accrued benefits

under such plan and for the purpose of determining the accrual of benefits under such plan.

“(C) An individual reemployed under such chapter is entitled to accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals only to the extent the individual makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the individual would have been permitted or required to contribute had the individual remained continuously employed by the employer throughout the period of qualified military service. Any payment to such plan shall be made during the period beginning with the date of reemployment and whose duration is 3 times the period of the qualified military service (but not greater than 5 years).

“(9) PLANS NOT SUBJECT TO TITLE 38.—This subsection shall not apply to any retirement plan to which chapter 43 of title 38, United States Code, does not apply.

“(10) REFERENCES.—For purposes of this section, any reference to chapter 43 of title 38, United States Code, shall be treated as a reference to such chapter as in effect on December 12, 1994 (without regard to any subsequent amendment).”

(2) EFFECTIVE DATE.—The amendment made by this subsection shall be effective as of December 12, 1994.

(p) REPORTING OF REAL ESTATE TRANSACTIONS.—

(1) IN GENERAL.—Paragraph (3) of section 6045(e) (relating to prohibition of separate charge for filing return) is amended by adding at the end the following new sentence: “Nothing in this paragraph shall be construed to prohibit the real estate reporting person from taking into account its cost of complying with such requirement in establishing its charge (other than a separate charge for complying with such requirement) to any customer for performing services in the case of a real estate transaction.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in section 1015(e)(2)(A) of the Technical and Miscellaneous Revenue Act of 1988.

(q) CLARIFICATION OF DENIAL OF DEDUCTION FOR STOCK REDEMPTION EXPENSES.

(1) IN GENERAL.—Paragraph (1) of section 162(k) is amended by striking “the redemption of its stock” and inserting “the reacquisition of its stock or of the stock of any related person (as defined in section 465(b)(3)(C))”.

(2) CERTAIN DEDUCTIONS PERMITTED.—Subparagraph (A) of section 162(k)(2) is amended by striking “or” at the end of clause (i), by redesignating clause (ii) as clause (iii), and by inserting after clause (i) the following new clause:

“(ii) deduction for amounts which are properly allocable to indebtedness and amortized over the term of such indebtedness, or”.

(3) CLERICAL AMENDMENT.—The subsection heading for subsection (k) of section 162 is amended by striking “REDEMPTION” and inserting “REACQUISITION”.

(4) EFFECTIVE DATE.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this subsection shall apply to amounts paid or incurred after September 13, 1995, in taxable years ending after such date.

(B) PARAGRAPH (2).—The amendment made by paragraph (2) shall take effect as if included in the amendment made by section 613 of the Tax Reform Act of 1986.

(r) CLERICAL AMENDMENT TO SECTION 404.—

(1) IN GENERAL.—Paragraph (1) of section 404(j) is amended by striking “(10)” and inserting “(9)”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 713(d)(4)(A) of the Deficit Reduction Act of 1984.

(s) PASSIVE INCOME NOT TO INCLUDE FSC INCOME, ETC.—

(1) IN GENERAL.—Paragraph (2) of section 1296(b) is amended by striking “or” at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting “, or”, and by inserting after subparagraph (C) the following new subparagraph:

“(D) which is foreign trade income of a FSC or export trade income of an export trade corporation (as defined in section 971).”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 1235 of the Tax Reform Act of 1986.

(t) MISCELLANEOUS CLERICAL AMENDMENTS.—

(1) Subclause (II) of section 56(g)(4)(C)(ii) is amended by striking “of the subclause” and inserting “of subclause”.

(2) Paragraph (2) of section 72(m) is amended by inserting “and” at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(3) Paragraph (2) of section 86(b) is amended by striking “adusted” and inserting “adjusted”.

(4)(A) The heading for section 112 is amended by striking “combat pay” and inserting “combat zone compensation”.

(B) The item relating to section 112 in the table of sections for part III of subchapter B of chapter 1 is amended by striking “combat pay” and inserting “combat zone compensation”.

(C) Paragraph (1) of section 3401(a) is amended by striking “combat pay” and inserting “combat zone compensation”.

(5) Clause (i) of section 172(h)(3)(B) is amended by striking the comma at the end thereof and inserting a period.

(6) Clause (ii) of section 543(a)(2)(B) is amended by striking “section 563(c)” and inserting “section 563(d)”.

(7) Paragraph (1) of section 958(a) is amended by striking “sections 955(b)(1) (A) and (B), 955(c)(2)(A)(ii), and 960(a)(1)” and inserting “section 960(a)(1)”.

(8) Subsection (g) of section 642 is amended by striking “under 2621(a)(2)” and inserting “under section 2621(a)(2)”.

(9) Section 1463 is amended by striking “this subsection” and inserting “this section”.

(10) Subsection (k) of section 3306 is amended by inserting a period at the end thereof.

(11) The item relating to section 4472 in the table of sections for subchapter B of chapter 36 is amended by striking “and special rules”.

(12) Paragraph (3) of section 5134(c) is amended by striking “section 6662(a)” and inserting “section 6665(a)”.

(13) Paragraph (2) of section 5206(f) is amended by striking “section 5(e)” and inserting “section 105(e)”.

(14) Paragraph (1) of section 6050B(c) is amended by striking “section 85(c)” and inserting “section 85(b)”.

(15) Subsection (k) of section 6166 is amended by striking paragraph (6).

(16) Subsection (e) of section 6214 is amended to read as follows:

“(e) CROSS REFERENCE.—

“For provision giving Tax Court jurisdiction to order a refund of an overpayment and to award sanctions, see section 6512(b)(2).”

(17) The section heading for section 6043 is amended by striking the semicolon and inserting a comma.

(18) The item relating to section 6043 in the table of sections for subpart B of part III of subchapter A of chapter 61 is amended by striking the semicolon and inserting a comma.

(19) The table of sections for part I of subchapter A of chapter 68 is amended by striking the item relating to section 6662.

(20)(A) Section 7232 is amended—

(i) by striking “lubricating oil,” in the heading, and

(ii) by striking “lubricating oil,” in the text.

(B) The table of sections for part II of subchapter A of chapter 75 is amended by striking “lubricating oil,” in the item relating to section 7232.

(21) Paragraph (1) of section 6701(a) of the Omnibus Budget Reconciliation Act of 1989 is amended by striking “subclause (IV)” and inserting “subclause (V)”.

(22) Clause (ii) of section 7304(a)(2)(D) of such Act is amended by striking “subsection (c)(2)” and inserting “subsection (c)”.

(23) Paragraph (1) of section 7646(b) of such Act is amended by striking “section 6050H(b)(1)” and inserting “section 6050H(b)(2)”.

(24) Paragraph (10) of section 7721(c) of such Act is amended by striking “section 6662(b)(2)(C)(ii)” and inserting “section 6661(b)(2)(C)(ii)”.

(25) Subparagraph (A) of section 7811(i)(3) of such Act is amended by inserting “the first place it appears” before “in clause (i)”.

(26) Paragraph (10) of section 7841(d) of such Act is amended by striking “section 381(a)” and inserting “section 381(c)”.

(27) Paragraph (2) of section 7861(c) of such Act is amended by inserting “the second place it appears” before “and inserting”.

(28) Paragraph (1) of section 460(b) is amended by striking “the look-back method of paragraph (3)” and inserting “the look-back method of paragraph (2)”.

(29) Subparagraph (C) of section 50(a)(2) is amended by striking “subsection (c)(4)” and inserting “subsection (d)(5)”.

(30) Subparagraph (B) of section 172(h)(4) is amended by striking the material following the heading and preceding clause (i) and inserting “For purposes of subsection (b)(2)—”.

(31) Subparagraph (A) of section 355(d)(7) is amended by inserting “section” before “267(b)”.

(32) Subparagraph (C) of section 420(e)(1) is amended by striking “mean” and inserting “means”.

(33) Paragraph (4) of section 537(b) is amended by striking “section 172(i)” and inserting “section 172(f)”.

(34) Subparagraph (B) of section 613(e)(1) is amended by striking the comma at the end thereof and inserting a period.

(35) Paragraph (4) of section 856(a) is amended by striking “section 582(c)(5)” and inserting “section 582(c)(2)”.

(36) Sections 904(f)(2)(B)(i) and 907(c)(4)(B)(iii) are each amended by inserting “(as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)” after “section 172(h)”.

(37) Subsection (b) of section 936 is amended by striking “subparagraphs (D)(ii)(I)” and inserting “subparagraphs (D)(ii)”.

(38) Subsection (c) of section 2104 is amended by striking “subparagraph (A), (C), or (D) of section 861(a)(1)” and inserting “section 861(a)(1)(A)”.

(39) Subparagraph (A) of section 280A(c)(1) is amended to read as follows:

“(A) as the principal place of business for any trade or business of the taxpayer.”

(40) Section 6038 is amended by redesignating the subsection relating to cross references as subsection (f).

(41) Clause (iv) of section 6103(e)(1)(A) is amended by striking all that follows “provisions of” and inserting “section 1(g) or 59(j);”.

(42) The subsection (f) of section 6109 of the Internal Revenue Code of 1986 which was added by section 2201(d) of Public Law 101–624 is redesignated as subsection (g).

(43) Subsection (b) of section 7454 is amended by striking “section 4955(e)(2)” and inserting “section 4955(f)(2)”.

(44) Subsection (d) of section 11231 of the Revenue Reconciliation Act of 1990 shall be applied as if “comma” appeared instead of “period” and as if the paragraph (9) proposed to be added ended with a comma.

(45) Paragraph (1) of section 11303(b) of the Revenue Reconciliation Act of 1990 shall be applied as if “paragraph” appeared instead of “subparagraph” in the material proposed to be stricken.

(46) Subsection (f) of section 11701 of the Revenue Reconciliation Act of 1990 is amended by inserting “(relating to definitions)” after “section 6038(e)”.

(47) Subsection (i) of section 11701 of the Revenue Reconciliation Act of 1990 shall be applied as if “subsection” appeared instead of “section” in the material proposed to be stricken.

(48) Subparagraph (B) of section 11801(c)(2) of the Revenue Reconciliation Act of 1990 shall be applied as if “section 56(g)” appeared instead of “section 59(g)”.

(49) Subparagraph (C) of section 11801(c)(8) of the Revenue Reconciliation Act of 1990 shall be applied as if “reorganizations” appeared instead of “reorganization” in the material proposed to be stricken.

(50) Subparagraph (H) of section 11801(c)(9) of the Revenue Reconciliation Act of 1990 shall be applied as if “section 1042(c)(1)(B)” appeared instead of “section 1042(c)(2)(B)”.

(51) Subparagraph (F) of section 11801(c)(12) of the Revenue Reconciliation Act of 1990 shall be applied as if “and (3)” appeared instead of “and (E)”.

(52) Subparagraph (A) of section 11801(c)(22) of the Revenue Reconciliation Act of 1990 shall be applied as if “chapters 21” appeared instead of “chapter 21” in the material proposed to be stricken.

(53) Paragraph (3) of section 11812(b) of the Revenue Reconciliation Act of 1990 shall be applied by not executing the amendment therein to the heading of section 42(d)(5)(B).

(54) Clause (i) of section 11813(b)(9)(A) of the Revenue Reconciliation Act of 1990 shall be applied as if a comma appeared after “(3)(A)(ix)” in the material proposed to be stricken.

(55) Subparagraph (F) of section 11813(b)(13) of the Revenue Reconciliation Act of 1990 shall be applied as if “tax” appeared after “investment” in the material proposed to be stricken.

(56) Paragraph (19) of section 11813(b) of the Revenue Reconciliation Act of 1990 shall be applied as if “Paragraph (20) of section 1016(a), as redesignated by section 11801,” appeared instead of “Paragraph (21) of section 1016(a)”.

(57) Paragraph (5) section 8002(a) of the Surface Transportation Revenue Act of 1991 shall be applied as if “4481(e)” appeared instead of “4481(c)”.

(58) Section 7872 is amended—

(A) by striking “foregone” each place it appears in subsections (a) and (e)(2) and inserting “forgone”, and

(B) by striking “FOREGONE” in the heading for subsection (e) and the heading for paragraph (2) of subsection (e) and inserting “FORGONE”.

(59) Paragraph (7) of section 7611(h) is amended by striking “appropriate” and inserting “appropriate”.

(60) The heading of paragraph (3) of section 419A(c) is amended by striking “SEVERENCE” and inserting “SEVERANCE”.

(61) Clause (ii) of section 807(d)(3)(B) is amended by striking “Commissioners’ ” and inserting “Commissioners’ ”.

(62) Subparagraph (B) of section 1274A(c)(1) is amended by striking “instument” and inserting “instrument”.

(63) Subparagraph (B) of section 724(d)(3) by striking “Subparagraph” and inserting “Subparagraph”.

(64) The last sentence of paragraph (2) of section 42(c) is amended by striking “of 1988”.

(65) Paragraph (1) of section 9707(d) is amended by striking “diligence,” and inserting “diligence”.

(66) Subsection (c) of section 4977 is amended by striking “section 132(i)(2)” and inserting “section 132(h)”.

(67) The last sentence of section 401(a)(20) is amended by striking “section 211” and inserting “section 521”.

(68) Subparagraph (A) of section 402(g)(3) is amended by striking “subsection (a)(8)” and inserting “subsection (e)(3)”.

(69) The last sentence of section 403(b)(10) is amended by striking “an direct” and inserting “a direct”.

(70) Subparagraph (A) of section 4973(b)(1) is amended by striking “sections 402(c)” and inserting “section 402(c)”.

(71) Paragraph (12) of section 3405(e) is amended by striking “(b)(3)” and inserting “(b)(2)”.

(72) Paragraph (41) of section 521(b) of the Unemployment Compensation Amendments of 1992 shall be applied as if “section” appeared instead of “sections” in the material proposed to be stricken.

(73) Paragraph (27) of section 521(b) of the Unemployment Compensation Amendments of 1992 shall be applied as if “Section 691(c)(5)” appeared instead of “Section 691(c)”.

(74) Paragraph (5) of section 860F(a) is amended by striking “paragraph (1)” and inserting “paragraph (2)”.

(75) Paragraph (1) of section 415(k) is amended by adding “or” at the end of subparagraph (C), by striking subparagraphs (D) and (E), and by redesignating subparagraph (F) as subparagraph (D).

(76) Paragraph (2) of section 404(a) is amended by striking “(18),”.

(77) Clause (ii) of section 72(p)(4)(A) is amended to read as follows:

“(ii) SPECIAL RULE.—The term ‘qualified employer plan’ shall not include any plan which was (or was determined to be) a qualified employer plan or a government plan.”

(78) Sections 461(i)(3)(C) and 1274(b)(3)(B)(i) are each amended by striking “section 6662(d)(2)(C)(ii)” and inserting “section 6662(d)(2)(C)(iii)”.

(79) Subsection (a) of section 164 is amended by striking the paragraphs relating to the generation-skipping tax and the environmental tax imposed by section 59A and by inserting after paragraph (3) the following new paragraphs:

“(4) The GST tax imposed on income distributions.

“(5) The environmental tax imposed by section 59A.”

(u) CERTAIN PROPERTY NOT TREATED AS SECTION 179 PROPERTY.—

(1) IN GENERAL.—Paragraph (1) of section 179(d) is amended by adding at the end thereof the following new sentence: “Such term shall not include any property described in section 50(b) and shall not include air conditioning or heating units and horses.”

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to property placed in service after May 14, 1996.

## **I. INTRODUCTION**

### **A. Purpose and Summary**

The purpose of the Small Business Job Protection Act is to reduce the tax barriers that interfere with the ability of America's small businesses to grow and create jobs. The bill accomplishes this objective through a variety of provisions that are designed to provide flexibility to and reduced costs for small businesses and their workers. In addition, the pension reforms in the bill will help tens of millions of Americans save for retirement and will make these retirement savings more secure.

The bill includes the following principal provisions: (1) increase in expensing for small business from \$17,500 to \$25,000; (2) expansion of the FICA tip credit; (3) extension of certain expiring provisions, including the work opportunity tax credit and employer-provided educational assistance; (4) reforms of rules governing S corporations; and (5) extensive pension reforms. The bill also includes other small business-related tax provisions. To offset the cost of these provisions, the bill: (1) phases out and repeals the Puerto Rico and possession tax credit; (2) repeals the 50-percent interest income exclusion for financial institution loans to ESOPs; (3) applies a look-through rules for purposes of characterizing certain subpart F income as unrelated business income; (4) modifies the income forecast method of determining depreciation deductions; (5) modifies the exclusion of damages received on account of personal injury or sickness; and (6) repeals advance refunds of the diesel fuel tax for purchasers of diesel-powered cars, vans, and light trucks. Finally, the bill also contains a number of technical corrections provisions.

### **B. Background and Need for Legislation**

Many of the items contained in the Small Business Job Protection Act were contained in the Balanced Budget Act of 1995 (H.R. 2491), which was passed by the Congress and vetoed by President Clinton. The need for this legislation is as urgent today as it was when Congress passed the Balanced Budget Act of 1995.

Small business are the most vibrant segment of our economy. They are responsible for the lion's share of job growth and ingenuity in this country. However, recordkeeping and other actions required to comply with the tax laws impose significant costs on small businesses. The tax laws should be easier for small businesses to comply with and as small of a burden as possible. Similarly, education and employment opportunity must be strongly encouraged. The Small Business Job Protection Act is an important first step in this regard.

### **C. Legislative History**

#### ***Committee bill***

H.R. 3448 was introduced by Chairman Archer on May 14, 1996. The bill was considered in a Committee markup on May 14, 1996, and was ordered favorably reported, as amended, by a roll call vote of 33 yeas and 3 nays.

The Chairman's amendment in the nature of a substitute added two provisions to the bill as introduced: (1) clarify that the present-law rule in section 280A permits deductions for expenses related to a storage unit in a taxpayer's home regularly used for inventory or product samples; and (2) prospectively deny expensing for certain property, including property described in section 50(b), air conditioning and heating units, and horses.

In addition, the Committee approved four other amendments (by voice vote) to the Chairman's amendment in the nature of a substitute: (1) an amendment by Mr. Crane to provide an exception if there is a binding contract negotiated before the October 13, 1995, effective date of the bill's repeal of the 50-percent interest exclusion for employee stock ownership plan loans; (2) an amendment by Mr. Thomas (California) to provide tax-exempt status for certain charitable risk pool organizations operated solely to pool insurance risks of section 501(c)(3) charitable organizations; (3) an amendment by Mr. Camp to exclude from unrelated business income certain dues paid to agricultural and horticultural organizations; and (4) an amendment by Mr. Neal relating to the employment tax status of certain fishermen who receive compensation in the form of a portion of the catch, with a revenue offset to require reporting on certain purchases of fish. The Committee approved the Chairman's amendment in the nature of a substitute, as amended, by voice vote.

#### ***Committee hearings***

Committee hearings have been held during the 104th Congress related to various provisions of the bill.

Full Committee hearings were held on January 5 and 10–12, 1995 on the "Contract With America" revenue provisions generally, and January 24–26 and 31, and February 1, 1995, on savings and investment provisions. The increased expensing for small business was included in these hearings. Oversight Subcommittee held a hearing on expiring tax provisions on May 9, 1995. The subchapter S and pension simplification provisions were derived from previous Committee tax simplification provisions. These provisions, and the revenue-offset provisions, were also included in the Balanced Budget Act of 1995 as passed by the Congress and vetoed by the President.



## II. EXPLANATION OF THE BILL

### SMALL BUSINESS AND OTHER TAX PROVISIONS

#### A. Small Business Provisions

##### 1. Increase in expensing for small businesses (sec. 1111 of the bill and sec. 179 of the Code)

###### *Present Law*

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$17,500 of the cost of qualifying property placed in service for the taxable year (sec. 179).<sup>1</sup> In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The \$17,500 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

###### *Reasons for Change*

The Committee believes that section 179 expensing provides two important benefits for small businesses. First, it lowers the cost of capital for tangible property used in a trade or business. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. The Committee would enhance these benefits by increasing the amount allowed to be expensed under section 179.

###### *Explanation of Provision*

The bill increases the \$17,500 amount allowed to be expensed under Code section 179 to \$25,000. The increase is phased in as follows:

	<i>Taxable year beginning in—</i>	<i>Maximum expensing</i>
1996	.....	\$18,500
1997	.....	19,000
1998	.....	20,000
1999	.....	21,000
2000	.....	22,000

<sup>1</sup> The amount permitted to be expensed under Code section 179 is increased by up to an additional \$20,000 for certain property placed in service by a business located in an empowerment zone (sec. 1397A).

<i>Taxable year beginning in—</i>	<i>Maximum expensing</i>
2001 .....	23,000
2002 .....	23,500
2003 and thereafter .....	25,000

### ***Effective Date***

The provision is effective for property placed in service in taxable years beginning after December 31, 1995, subject to the phase-in schedule set forth above.

## **2. Tax credit for Social Security taxes paid with respect to employee cash tips (sec. 1112 of the bill and sec. 45B of the Code)**

### ***Present Law***

Employee tip income is treated as employer-provided wages for purposes of the Federal Insurance Contributions Act ("FICA"). Employees are required to report to the employer the amount of tips received. The Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") provided a business tax credit with respect to certain employer FICA taxes paid with respect to tips treated as paid by the employer. The credit applies to tips received from customers in connection with the provision of food or beverages for consumption on the premises of an establishment with respect to which the tipping of employees is customary. OBRA 1993 provided that the FICA tip credit is effective for taxes paid after December 31, 1993. Temporary Treasury regulations provide that the tax credit is available only with respect to tips reported by the employee. The temporary regulations also provide that the credit is effective for FICA taxes paid by an employer after December 31, 1993, with respect to tips received for services performed after December 31, 1993.

### ***Reasons for Change***

The Committee believes it appropriate to clarify the effective date and scope of the credit for FICA taxes paid on employer cash tips. Despite the statutory language, there has been some confusion regarding the effective date. The FICA tip credit was included in the Senate version of H.R. 4210, the Tax Fairness and Economic Growth Act of 1992, and was included in the conference agreement of H.R. 4210 as passed by the 102d Congress and vetoed by President Bush. The effective date of that provision would have applied to "tips received and wages paid after the date of enactment." The FICA tip credit was also included in the House and Senate versions of H.R. 11, the Revenue Act of 1992, as considered by the 102d Congress. The effective date of both those provisions was the same as in H.R. 4210, specifically tips received and wages paid after the date of enactment. The provision was included in the conference agreement of the H.R. 11, as adopted by the Congress and vetoed by President Bush; however, the effective date of that provision was modified to apply to "taxes paid after" December 31, 1992, i.e., no limitation with respect to tips earned after December 31, 1992, was included.

In 1993, the House and Senate versions of the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") did not contain the FICA

tip provision, but it was included in the conference agreement. The FICA tip provision that was included in OBRA 1993 has the same effective date as the provision in the conference agreement for H.R. 11, except that the date was moved one year, to taxes paid after December 31, 1993. The Committee believes that the legislative history of this provision indicates intent to change the effective date, and that the Treasury's interpretation of that date is not consistent with the provision as finally adopted.

The Committee also believes it appropriate to apply the credit to all persons who provide food and beverages, whether for consumption on or off the premises.

### ***Explanation of Provision***

The bill clarifies the credit with respect to employer FICA taxes paid on tips by providing that the credit is (1) available whether or not the employee reported the tips on which the employer FICA taxes were paid pursuant to section 6053(a), and (2) effective with respect to taxes paid after December 31, 1993, regardless of when the services with respect to which the tips are received were performed.

The bill also modifies the credit so that it applies with respect to tips received from customers in connection with the provision of food or beverages, regardless of whether the food or beverages are for consumption on the premises of the establishment.

### ***Effective Date***

The clarifications relating to the effective date and nonreported tips are effective as if included in OBRA 1993. The provision expanding the tip credit to the provision of food or beverages not for consumption on the premises of the establishment is effective with respect to FICA taxes paid on tips received with respect to services performed after December 31, 1996.

## **3. Home office deduction: Treatment of storage of product samples (sec. 1113 of the bill and sec. 280A of the Code)**

### ***Present Law***

A taxpayer's business use of his or her home may give rise to a deduction for the business portion of expenses related to operating the home (e.g., a portion of rent or depreciation and repairs). Code section 280A(c)(1) provides, however, that business deductions generally are allowed only with respect to a portion of a home that is used exclusively and regularly in one of the following ways: (1) as the principal place of business for a trade or business; (2) as a place of business used to meet with patients, clients, or customers in the normal course of the taxpayer's trade or business; or (3) in connection with the taxpayer's trade or business, if the portion so used constitutes a separate structure not attached to the dwelling unit. In the case of an employee, the Code further requires that the business use of the home must be for the convenience of the employer (sec. 280A(c)(1)). These rules apply to houses, apartments, condominiums, mobile homes, boats, and other similar property used as the taxpayer's home (sec. 280A(f)(1)).

Section 280A(c)(2) contains a special rule that allows a home office deduction for business expenses related to a space within a home that is used on a regular (even if not exclusive) basis as a storage unit for the inventory of the taxpayer's trade or business of selling products at retail or wholesale, but only if the home is the sole fixed location of such trade or business.

Home office deductions may not be claimed if they create (or increase) a net loss from a business activity, although such deductions may be carried over to subsequent taxable years (sec. 280A(c)(5)).

### ***Reasons for Change***

The Committee believes that present-law section 280A(c)(2) should be clarified so that taxpayers who sell products at retail or wholesale, and regularly store such products at home, need not attempt to distinguish between inventory and product samples. This clarification will simplify the administration of present-law section 280A(c)(2).

### ***Explanation of Provision***

The bill clarifies that the special rule contained in present-law section 280A(c)(2) permits deductions for expenses related to a storage unit in a taxpayer's home regularly used for inventory or product samples (or both) of the taxpayer's trade or business of selling products at retail or wholesale, provided that the home is the sole fixed location of such trade or business.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1995.

## **4. Treatment of certain charitable risk pools (sec. 1114 of the bill and new sec. 501(n) of the Code)**

### ***Present Law***

Organizations described in section 501(c)(3) (which are referred to as "charities") generally are exempt from Federal income tax and are eligible to receive tax-deductible contributions and to use the proceeds of tax-exempt financing. Section 501(c)(3) requires that an organization be organized and operated exclusively for a charitable or other specifically enumerated exempt purpose in order to qualify for tax-exempt status under that section.

Section 501(c)(3) provides that an organization that is organized and operated exclusively for charitable purposes is entitled to tax-exempt status under that section only if the organization satisfies the additional requirements that no part of its net earnings inures to the benefit of any private individual or shareholder (referred to as the "private inurement test") and only if the organization does not engage in political campaign activity on behalf of (or in opposition to) any candidate for public office and does not engage in substantial lobbying activities.

Section 501(m) provides that an organization described in section 501(c)(3) or 501(c)(4) of the Code is exempt from tax only if no sub-

stantial part of its activities consists of providing commercial-type insurance. For purposes of this rule, commercial-type insurance does not include insurance provided at substantially below cost to a class of charitable recipients.

Present law does not specifically accord tax-exempt status to an organization that pools insurable risks of a group of tax-exempt organizations described in section 501(c)(3).

### ***Reasons for Change***

The Committee believes that providing tax-exempt status to not-for-profit risk pools whose members are exclusively tax-exempt charitable organizations, and which obtain significant capital from nonmember charitable organizations, will help make liability insurance more affordable to charitable organizations.

### ***Explanation of Provision***

Under the bill, a qualified charitable risk pool is treated as organized and operated exclusively for charitable purposes. The provision makes inapplicable to a qualified charitable risk pool the present-law rule under section 501(m) that a charitable organization described in section 501(c)(3) is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance.

The bill defines a qualified charitable risk pool as an organization organized and operated solely to pool insurable risks of its members (other than medical malpractice risks) and to provide information to its members with respect to loss control and risk management. Because a qualified charitable risk pool must be organized and operated solely to pool insurable risks of its members and to provide information to members with respect to loss control and risk management, no profit or other benefit may be accorded to any member of the organization other than through providing members with insurance coverage below the cost of comparable commercial coverage and through providing members with loss control and risk management information. Only charitable tax-exempt organizations described in section 501(c)(3) may be members of a qualified charitable risk pool.

The bill further requires that a qualified charitable risk pool is required to (1) be organized as a nonprofit organization under State law authorizing risk pooling for charitable organizations; (2) be exempt from State income tax; (3) obtain at least \$1 million in start-up capital from nonmember charitable organizations; (4) be controlled by a board of directors elected by its members; and (5) provide in its organizational documents that members must be tax-exempt charitable organizations at all times, and if a member loses that status it must immediately notify the organization, and that no insurance coverage applies to a member after the date of any final determination that the member no longer qualifies as a tax-exempt charitable organization.

To be entitled to tax-exempt status under section 501(c)(3), a qualified charitable risk pool described in the provision also must satisfy the other requirements of that section (i.e., the private

inurement test and the prohibition of political campaign activities and substantial lobbying).

### ***Effective Date***

The provision applies to taxable years beginning after the date of enactment.

## **5. Treatment of dues paid to agricultural or horticultural organizations (sec. 1115 of the bill and sec. 512 of the Code)**

### ***Present Law***

Tax-exempt organizations generally are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511–514). Dues payments made to a membership organization generally are not subject to the UBIT. However, several courts have held that, with respect to postal labor organizations, dues payments were subject to the UBIT when received from individuals who were not postal workers, but who became "associate" members for the purpose of obtaining health insurance available to members of the organization. See *National League of Postmasters of the United States v. Commissioner*, No. 8032–93, T.C. Memo (May 11, 1995); *American Postal Workers Union, AFL–CIO v. United States*, 925 F.2d 480 (D.C. Cir. 1991); *National Association of Postal Supervisors v. United States*, 944 F.2d 859 (Fed. Cir. 1991).

In Rev. Proc. 95–21 (issued March 23, 1995), the IRS set forth its position regarding when associate member dues payments received by an organization described in section 501(c)(5) will be treated as subject to the UBIT. The IRS stated that dues payments from associate members will not be treated as subject to UBIT unless, for the relevant period, "the associate member category has been formed or availed of for the principal purpose of producing unrelated business income." Thus, under Rev. Proc. 95–21, the focus of the inquiry is upon the organization's purposes in forming the associate member category (and whether the purposes of that category of membership are substantially related to the organization's exempt purposes other than through the production of income) rather than upon the motive of the individuals who join as associate members.

### ***Reasons for Change***

The Committee believes that it is appropriate to clarify the treatment of certain limited dues payments from associate members of organizations described in section 501(c)(5) to curtail expensive and time consuming controversies regarding the treatment of such payments for purposes of the UBIT and to facilitate administration of the Code.

### ***Explanation of Provision***

Under the bill, if an agricultural or horticultural organization described in section 501(c)(5) requires annual dues not exceeding

\$100 to be paid in order to be a member of such organization, then in no event will any portion of such dues be subject to the UBIT by reason of any benefits or privileges to which members of such organization are entitled. For taxable years beginning after 1995, the \$100 amount will be indexed for inflation. The term “dues” is defined as “any payment required to be made in order to be recognized by the organization as a member of the organization.” Thus, if a person is recognized as a member of an organization by virtue of having paid annual dues for his or her membership, then any subsequent payments made by that person during the year to purchase another membership in the same organization would not be within the scope of the provision.

#### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1994.

### **6. Clarify employment tax status of certain fishermen (sec. 1116(a) of the bill and sec. 3121(b)(20) of the Code)**

#### ***Present Law***

Under present law, service as a crew member on a fishing vessel is generally excluded from the definition of employment for purposes of income tax withholding on wages and for purposes of the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA) taxes if the operating crew of the boat normally consists of fewer than 10 individuals, the individual receives a share of the catch based on the total catch, and the individual does not receive cash remuneration other than proceeds from the sale of the individual's share of the catch. Crew members to which the exemption applies are subject to self-employment taxes. Special reporting requirements apply to the operators of boats on which exempt crew members serve.

#### ***Reasons for Change***

The Committee believes that providing a statutory definition for determining whether the crew of a fishing boat normally consists of fewer than 10 individuals would make the provision easier to apply and administer. Providing that the exemption continues to apply if an individual receives, in addition to a share of the catch, a small amount of cash for certain duties performed would recognize long-standing industry practice.

#### ***Explanation of Provision***

The operating crew of a boat is treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals. In addition, the exemption applies if the crew member receives, in addition to the cash remuneration permitted under present law, cash remuneration which does not exceed \$100 per trip, is contingent on a minimum catch, and is paid solely for additional duties (e.g., as mate, engineer, or cook) for which additional cash remuneration is customary. The reporting

requirements applicable to boat operators are modified to take into account the additional cash remuneration that may be paid under the proposal.

### ***Effective Date***

The provision applies to remuneration paid after December 31, 1996. In addition, the provision applies to remuneration paid after December 31, 1984, and before January 1, 1997, unless the payor treated such remuneration when paid as subject to wage withholding and employment taxes.

## **7. Reporting requirements for purchasers of fish (sec. 1116(b) of the bill and new sec. 6050Q of the Code)**

### ***Present Law***

Under present law, a person engaged in a trade or business who makes payments during the calendar year of \$600 or more to a person for “rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, or other income” must file an information return with the Internal Revenue Service reporting the amount of such payments, as well as the name, address, and taxpayer identification number of the person to whom such payments were made (Code sec. 6041). A similar statement must also be furnished to the person to whom such payments were made. Treasury regulations provide that payments for “merchandise” are not required to be reported under this provision (Treas. reg. sec. 1.6041-3(d)). Consequently, information reporting is generally not required with respect to purchases of fish or other forms of aquatic life. Information reporting is required by a person engaged in a trade or business who, in the course of that trade or business, receives more than \$10,000 in cash in one transaction (or several related transactions) (Code sec. 6050I).

### ***Reasons for Change***

The Committee believes that requiring information reporting will enhance compliance with the internal revenue laws.

### ***Explanation of Provision***

The provision requires persons engaged in the trade or business of purchasing fish for resale who pay more than \$600 in cash in a calendar year for fish or other forms of aquatic life from any seller engaged in the trade or business of catching fish to file information reports with the Secretary regarding such purchases. A copy of the report must be provided to the seller.

### ***Effective Date***

The provision is effective for purchases made after December 31, 1996.



## **B. Extension of Certain Expiring Provisions**

### **1. Work opportunity tax credit (sec. 1201 of the bill and sec. 51 of the Code)**

#### *Prior Law*

##### *General rules*

Prior to January 1, 1995, the targeted jobs tax credit was available on an elective basis for employers hiring individuals from one or more of nine targeted groups. The credit generally was equal to 40 percent of qualified first-year wages. Qualified first-year wages consisted of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period began the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

No more than \$6,000 of wages during the first year of employment were permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual was \$2,400.

With respect to economically disadvantaged summer youth employees, the credit was equal to 40 percent of up to \$3,000 of qualified first-year wages, for a maximum credit of \$1,200.

The deduction for wages was reduced by the amount of the credit.

##### *Certification of members of targeted groups*

In general, an individual was not treated as a member of a targeted group unless certification that the individual was a member of such a group was received or requested in writing by the employer from the designated local agency on or before the day on which the individual began work for the employer. In the case of a certification of an economically disadvantaged youth participating in a cooperative education program, this requirement was satisfied if the certification was requested or received from the participating school on or before the day on which the individual began work for the employer. The "designated local agency" was the State employment security agency.

If a certification was incorrect because it was based on false information provided as to the employee's membership in a targeted group, the certification was revoked. Wages paid after the revocation notice was received by the employer were not treated as qualified wages.

The U.S. Employment Service, in consultation with the Internal Revenue Service, was directed to take whatever steps necessary to keep employers informed of the availability of the credit.

##### *Targeted groups eligible for the credit*

The nine groups eligible for the credit were either recipients of payments under means-tested transfer programs, economically disadvantaged (as measured by family income), or disabled individuals.

*(1) Vocational rehabilitation referrals*

Vocational rehabilitation referrals were those individuals who had a physical or mental disability that constituted a substantial handicap to employment and who had been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973, or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification was provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee had met the above conditions.

*(2) Economically disadvantaged youths*

Economically disadvantaged youths were individuals certified by the designated local employment agency as (1) members of economically disadvantaged families and (2) at least age 18 but not age 23 on the date they were hired by the employer. An individual was determined to be a member of an economically disadvantaged family if, during the six months immediately preceding the earlier of the month in which the determination occurred or the month in which the hiring date occurred, the individual's family income was, on an annual basis, not more than 70 percent of the Bureau of Labor Statistics' lower living standard. A determination that an individual was a member of an economically disadvantaged family was valid for 45 days from the date on which the determination was made.

Except as otherwise noted below, a determination of whether an individual was a member of an economically disadvantaged family was made on the same basis and was subject to the same 45-day limitation, where required in connection with the four other targeted groups that excluded individuals who were not economically disadvantaged.

*(3) Economically disadvantaged Vietnam-era veterans*

The third targeted group was Vietnam-era veterans certified by the designated local employment agency as members of economically disadvantaged families. For these purposes, a Vietnam-era veteran was an individual who had served on active duty (other than for training) in the Armed Forces for more than 180 days, or who had been discharged or released from active duty in the Armed Forces for a service-connected disability, but in either case, the active duty must have taken place after August 4, 1964, and before May 8, 1975. However, any individual who had served for a period of more than 90 days during which the individual was on active duty (other than for training) was not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule was intended to prevent employers who hired current members of the armed services (or those departed from service within the last 60-days) from receiving the credit.

*(4) SSI recipients*

The fourth targeted group was individuals receiving either Supplemental Security Income ("SSI") under Title XVI of the Social Security Act or State supplements described in section 1616 of that Act or section 212 of P.L. 93-66. To be an eligible employee, the individual must have received SSI payments during at least a one-month period ending during the 60-day period that ended on the date the individual was hired by the employer. The designated local agency was to issue the certification after a determination by the agency making the payments that these conditions had been fulfilled.

*(5) General assistance recipients*

General assistance recipients were individuals who received general assistance for a period of not less than 30 days if that period ended within the 60-day period ending on the date the individual was hired by the employer. General assistance programs were State and local programs that provided individuals with money payments, vouchers, or scrip based on need. These programs were referred to by a wide variety of names, including home relief, poor relief, temporary relief, and direct relief. Because of the wide variety of such programs, Congress provided that a recipient was an eligible employee only after the program had been designated by the Secretary of the Treasury as a program that provided money payments, vouchers, or scrip to needy individuals. Certification was performed by the designated local agency.

*(6) Economically disadvantaged former convicts*

The sixth targeted group included any individual who was certified by the designated local employment agency as (1) having at some time been convicted of a felony under State or Federal law, (2) being a member of an economically disadvantaged family, and (3) having been hired within five years of the later of release from prison or date of conviction.

*(7) Economically disadvantaged cooperative education students*

The seventh targeted group was youths who (1) actively participated in qualified cooperative education programs, (2) had attained age 16 but had not attained age 20, (3) had not graduated from high school or vocational school, and (4) were members of economically disadvantaged families. The definitions of a qualified cooperative education program and a qualified school were similar to those used in the Vocational Education Act of 1963. Thus, a qualified cooperative education program meant a program of vocational education for individuals who, through written cooperative arrangements between a qualified school and one or more employers, received instruction, including required academic instruction, by alternation of study in school with a job in any occupational field, but only if these two experiences were planned and supervised by the school and the employer so that each experience contributed to the student's education and employability.

For this purpose, a qualified school was (1) a specialized high school used exclusively or principally for the provision of vocational

education to individuals who were available for study in preparation for entering the labor market, (2) the department of a high school used exclusively or principally for providing vocational education to individuals who were available for study in preparation for entering the labor market, or (3) a technical or vocational school used exclusively or principally for the provision of vocational education to individuals who had completed or left high school and who were available for study in preparation for entering the labor market. In order for a nonpublic school to be a qualified school, it must have been exempt from income tax under section 501(a) of the Code.

The certification was performed by the school participating in the cooperative education program. After initial certification, an individual remained a member of the targeted group only while meeting the program participation, age, and degree status requirements of (a), (b), and (c), above.

*(8) AFDC recipients*

The eighth targeted group included any individual who was certified by the designated local employment agency as being eligible for Aid to Families with Dependent Children ("AFDC") and as having continually received such aid during the 90 days before being hired by the employer.

*(9) Economically disadvantaged summer youth employees*

The ninth targeted group included youths who performed services during any 90-day period between May 1 and September 15 of a given year and who were certified by the designated local agency as (1) being 16 or 17 years of age on the hiring date and (2) a member of an economically disadvantaged family. A youth must not have been an employee of the employer prior to that 90-day period. With respect to any particular employer, an employee could qualify only one time for this summer youth credit. If, after the end of the 90-day period, the employer continued to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages took into account wages paid to the youth while a qualified summer youth employee.

**Definition of wages**

In general, wages eligible for the credit were defined by reference to the definition of wages under the Federal Unemployment Tax Act (FUTA) in section 3306(b) of the Code, except that the dollar limits did not apply. Because wages paid to economically disadvantaged cooperative education students and to certain agricultural and railroad employees were not FUTA wages, special rules were provided for these wages.

Wages were taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee were for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages were for services in a trade or business was applied to each separate employer without treating related employers as a single employer.

### ***Other rules***

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit could not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit was allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year was less than the targeted jobs tax credit, the excess credit could be carried back three years and carried forward 15 years.

All employees of all corporations that were members of a controlled group of corporations were to be treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to \$6,000. Generally, under the controlled group rules, the credit allowed the group was the same as if the group were a single company. A comparable rule was provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that were under common control, so that all employees of such organizations generally were to be treated as if they were employed by a single person. The amount of targeted jobs tax credit allowable to each member of the controlled group was its proportionate share of the wages giving rise to the credit.

No credit was available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit was also not available for wages paid to an individual who was employed by the employer at any time during which the individual was not a certified member of a targeted group.

No credit was available for wages paid by an employer to an individual for services that were the same as, or substantially similar to, those services performed by employees participating in, or affected by, a strike or lockout during the period of such strike or lockout. This rule applied to wages paid to individuals whose principal place of employment was a plant or facility where there was a strike or lockout.

No credit was allowed for wages paid unless the eligible individual was either (1) employed by the employer for at least 90 days (14 days in the case of economically disadvantaged summer youth employees) or (2) had completed at least 120 hours (20 hours for summer youth) of services performed for the employer.

### ***Reasons for Change***

While the prior-law targeted jobs tax credit was the subject of some criticism, the Committee believes that a tax credit mechanism can provide an important incentive for employers to undertake the expense of providing jobs and training to economically disadvantaged individuals, many of whom are underskilled and/or undereducated. The bill creates a new program whose design will focus on individuals with poor workplace attachments, streamline administrative burdens, promote longer-term employment, and thereby reduce costs relative to the prior-law program. The Committee intends that this short-term program will provide the Congress and the Treasury and Labor Departments an opportunity to

assess fully the operation and effectiveness of the new credit as a hiring incentive.

### ***Explanation of Provision***

#### ***General rules***

The bill replaces the targeted jobs tax credit with the “work opportunity tax credit.” The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of six targeted groups. The credit generally is equal to 35 percent of qualified wages. Qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer. For a vocational rehabilitation referral, however, the period will begin on the day the individual begins work for the employer on or after the beginning of the individual’s vocational rehabilitation plan as under prior law.

Generally, no more than \$6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual is \$2,100. With respect to qualified summer youth employees, the maximum credit is 35 percent of up to \$3,000 of qualified first-year wages, for a maximum credit of \$1,050.

The deduction for wages is reduced by the amount of the credit.

#### ***Certification of members of targeted groups***

In general, an individual is not be treated as a member of a targeted group unless: (1) on or before the day the individual begins work for the employer, the employer received in writing a certification from the designated local agency that the individual is a member of a specific targeted group, or (2) on or before the day the individual is offered work with the employer, a pre-screening notice is completed with respect to that individual by the employer and within 14 days after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for certification. The pre-screening notice will contain the information provided to the employer by the individual that forms the basis of the employer’s belief that the individual is a member of a targeted group.

If a certification is incorrect because it is based on false information provided as to the individual’s membership in a targeted group, the certification will be revoked. No credit will be allowed on wages paid after receipt by the employer of the revocation notice.

If a designated local agency rejects a certification request it will have to provide a written explanation of the basis of the rejection.

#### ***Targeted groups eligible for the credit***

##### ***(1) Families receiving AFDC***

An eligible recipient is an individual certified by the designated local employment agency as being a member of a family eligible to receive benefits under AFDC or its successor program for a period of at least nine months part of which is during the 9-month period

ending on the hiring date. For these purposes, each member of the family receiving such assistance is treated as receiving such assistance and therefore is treated as an eligible recipient.

*(2) Qualified ex-felon*

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law, (2) being a member of a family that had an income during the six months before the earlier of the date of determination or the hiring date which on an annual basis is 70 percent or less of the Bureau of Labor Statistics lower living standard, and (3) having a hiring date within one year of release from prison or date of conviction.

*(3) High-risk-youth*

A high-risk youth is an individual certified as being at least 18 but not 25 on the hiring date and as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). Qualified wages will not include wages paid or incurred for services performed after the individual moves outside an empowerment zone or enterprise community.

*(4) Vocational rehabilitation referral*

Vocational rehabilitation referrals are those individuals who have a physical or mental disability that constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973 or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

*(5) Qualified summer youth employee*

Qualified summer youth employees are individuals: (1) who perform services during any 90-day period between May 1 and September 15, (2) who are certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who have not been an employee of that employer before, and (4) who are certified by the designated local agency as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). As with high-risk youths, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone or enterprise community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

*(6) Qualified Veteran*

A qualified veteran is a veteran who is a member of a family certified as receiving assistance under: (1) AFDC for a period of at least nine months part of which is during the 12-month period ending on the hiring date, or (2) a food stamp program under the Food Stamp Act of 1977 for a period of at least three months part of which is during the 12-month period ending on the hiring date.

Further, a qualified veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

***Definition of wages and other rules***

In general, wages eligible for the credit are defined by reference to the definition of wages under the Federal Unemployment Tax Act ("FUTA") in section 3306(b) of the Code, except that the dollar limits do not apply.

Wages are taken into account for purposes of the credit only if more than one-half of the wages paid during the taxable year to an employee are for services in the employer's trade or business. The test as to whether more than one-half of an employee's wages are for services in a trade or business are applied to each separate employer without treating related employers as a single employer.

In order to prevent taxpayers from eliminating all tax liability by reason of the credit, the amount of the credit may not exceed 90 percent of the taxpayer's income tax liability. Furthermore, the credit is allowed only after certain other nonrefundable credits had been taken. If, after applying these other credits, 90 percent of an employer's remaining tax liability for the year is less than the targeted jobs tax credit, the excess credit can be carried back three years and carried forward 15 years.

All employees of all corporations that are members of a controlled group of corporations are treated as if they were employees of the same corporation for purposes of determining the years of employment of any employee and wages for any employee up to \$6,000. Generally, under the controlled group rules, the credit allowed the group is the same as if the group were a single company. A comparable rule is provided in the case of partnerships, sole proprietorships, and other trades or businesses (whether or not incorporated) that are under common control, so that all employees of such organizations generally are treated as if they were employed by a single person. The amount of the credit allowable to each member of the controlled group is its proportionate share of the wages giving rise to the credit.

No credit is available for the hiring of certain related individuals (primarily dependents or owners of the taxpayer). The credit is also



not available for wages paid to an individual who is employed by the employer at any time during which the individual is not a certified member of a targeted group.

No credit is available for wages paid by an employer to an individual for services that are the same as, or substantially similar to, those services performed by employees participating in, or affected by, a strike or lockout during the period of such strike or lockout. This rule applies to wages paid to individuals whose principal place of employment is a plant or facility where there is a strike or lockout.

#### ***Minimum employment period***

No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 500 hours (120 hours in the case of a qualified summer youth employee).

#### ***Effective Date***

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer after June 30, 1996, and before July 1, 1997.

### **2. Employer-provided educational assistance (sec. 1202 of the bill and sec. 127 of the Code)**

#### ***Present and Prior Law***

For taxable years beginning before January 1, 1995, an employee's gross income and wages did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements. This exclusion, which expired for taxable years beginning after December 31, 1994, was limited to \$5,250 of educational assistance with respect to an individual during a calendar year. The exclusion applied whether or not the education was job related. In the absence of this exclusion, educational assistance is excludable from income only if it is related to the employee's current job.

#### ***Reasons for Change***

The section 127 exclusion for employer-provided educational assistance was first established on a temporary basis by the Revenue Act of 1978 (through 1983). It subsequently was extended, again on a temporary basis, by Public Law 98-611 (through 1985), by the Tax Reform Act of 1986 (through 1987), by the Technical and Miscellaneous Revenue Act of 1988 (through 1988), by the Omnibus Budget Reconciliation Act of 1989 (through September 30, 1990), by the Omnibus Budget Reconciliation Act of 1990 (through 1991), by the Tax Extension Act of 1991 (through June 30, 1992), and by the Omnibus Budget Reconciliation Act of 1993 (through December 31, 1994). Public Law 98-611 adopted a \$5,000 annual limit on the exclusion; this limit was subsequently raised to \$5,250 in the Tax Reform Act of 1986. The Technical and Miscellaneous Revenue Act of 1988 made the exclusion inapplicable to graduate-level courses.

The restriction on graduate-level courses was repealed by the Omnibus Budget Reconciliation Act of 1990, effective for taxable years beginning after December 31, 1990.

The Committee believes that the exclusion for employer-provided educational assistance should be extended because it provides needed assistance to workers and aids U.S. competitiveness by encouraging a better-educated work force. The need to balance the Federal budget necessitates some modification to the exclusion, as well as limiting it (as other expiring tax provisions), to a temporary extension. The Committee believes that the exclusion for employer-provided education should be targeted to those most in need of educational assistance—low- and middle-income employees who seek to obtain education which improves their skills and qualifies them for better jobs. Accordingly, the Committee believes it appropriate to reinstate the restriction on graduate-level education. However, due to the past practice of extending the exclusion after it has expired, the Committee is concerned that some taxpayers may have assumed that the exclusion would be available for graduate education during 1995. Thus, the restriction on graduate-level education is effective beginning in 1996.

### ***Explanation of Provision***

The bill extends the exclusion for employer-provided educational assistance for taxable years beginning after December 31, 1994, and before January 1, 1997. In years beginning after December 31, 1995, the exclusion would not apply with respect to graduate-level courses.

To the extent employers have previously filed Forms W-2 reporting the amount of educational assistance provided as taxable wages, present Treasury regulations would require the employer to file Forms W-2c (i.e., corrected Forms W-2) with the Internal Revenue Service.<sup>2</sup> It is intended that employers would also be required to provide copies of Form W-2c to affected employees.

The Secretary is directed to establish expedited procedures for the refund of any overpayment of employment taxes paid on excludable educational assistance provided in 1995 and 1996, including procedures for waiving the requirement that an employer obtain an employee's signature if the employer demonstrates to the satisfaction of the Secretary that any refund collected by the employer on behalf of the employee will be paid to the employee.

Because the exclusion is extended, no interest and penalties should be imposed if an employer failed to withhold income and employment taxes on excludable educational assistance or failed to report such educational assistance. Further, it is intended that the Secretary establish expedited procedures for refunding any interest and penalties relating to educational assistance previously paid.

### ***Effective Date***

The provision is effective with respect to taxable years beginning after December 31, 1994, and before January 1, 1997, and the re-

<sup>2</sup>Treasury regulation section 31.6051-1(c).

striction of the exclusion to undergraduate education is effective for taxable years beginning after December 31, 1995.

**3. Permanent extension of FUTA exemption for alien agricultural workers (sec. 1203 of the bill and sec. 3306 of the Code)**

***Present Law***

Generally, the Federal Unemployment Tax (“FUTA”) is imposed on farm operators who (1) employ 10 or more agricultural workers for some portion of each of 20 different days, each day being in a different calendar week or (2) have a quarterly payroll for agricultural services of at least \$20,000. An exclusion from FUTA was provided, however, for labor performed by an alien admitted to the United States to perform agricultural labor under section 214(c) and 101(a)(15)(H) of the Immigration and Nationality Act. This exclusion was effective for labor performed before January 1, 1995.

***Reasons for Change***

The committee believes that the FUTA exemption is appropriate in light of the ineligibility of those workers for FUTA benefits. Further, a permanent extension will provide certainty to taxpayers, ease tax administration, and obviate the need for further short-term extensions.

***Explanation of Provision***

The bill permanently extends the FUTA exemption for alien agricultural workers.

***Effective Date***

The provision is effective for labor performed on or after January 1, 1995.

**C. Provisions Relating to S Corporations**

**1. S corporations permitted to have 75 shareholders (sec. 1301 of the bill and sec. 1361 of the Code)**

***Present Law***

The taxable income or loss of an S corporation is taken into account by the corporation’s shareholders, rather than by the entity, whether or not such income is distributed. A small business corporation may elect to be treated as an S corporation. A “small business corporation” is defined as a domestic corporation which is not an ineligible corporation and which does not have (1) more than 35 shareholders, (2) as a shareholder, a person (other than certain trusts or estates) who is not an individual, (3) a nonresident alien as a shareholder, and (4) more than one class of stock. For purposes of the 35-shareholder limitation, a husband and wife are treated as one shareholder.

### ***Reasons for Change***

The Committee believes that increasing the maximum number of shareholders of an S corporation will facilitate corporate ownership by additional family members, employees and capital investors.

### ***Explanation of Provision***

The provision increases maximum number of shareholders from 35 to 75.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **2. Electing small business trusts (sec. 1302 of the bill and sec. 1361 of the Code)**

### ***Present Law***

Under present law, trusts other than grantor trusts, voting trusts, certain testamentary trusts and “qualified subchapter S trusts” may not be shareholders in a S corporation. A “qualified subchapter S trust” is a trust which, under its terms, (1) is required to have only one current income beneficiary (for life), (2) any corpus distributed during the life of the beneficiary must be distributed to the beneficiary, (3) the beneficiary’s income interest must terminate at the earlier of the beneficiary’s death or the termination of the trust, and (4) if the trust terminates during the beneficiary’s life, the trust assets must be distributed to the beneficiary. All the income (as defined for local law purposes) must be currently distributed to that beneficiary. The beneficiary is treated as the owner of the portion of the trust consisting of the stock in the S corporation.

### ***Reasons for Change***

The Committee believes that a trust that provides for income to be distributed to (or accumulated for) a class of individuals should be allowed to hold S corporation stock. This would allow an individual to establish a trust to hold S corporation stock and “spray” income among family members (or others) who are beneficiaries of the trust. The Committee believes allowing such an arrangement will facilitate family financial planning.

### ***Explanation of Provision***

#### ***In general***

The provision allows stock in an S corporation to be held by certain trusts (“electing small business trusts”). In order to qualify for this treatment, all beneficiaries of the trust must be individuals or estates eligible to be S corporation shareholders, except that charitable organizations may hold contingent remainder interests. No interest in the trust may be acquired by purchase. For this purpose, “purchase” means any acquisition of property with a cost

basis (determined under sec. 1012). Thus, interests in the trust must be acquired by reason of gift, bequest, etc.

A trust must elect to be treated as an electing small business trust. An election applies to the taxable year for which made and could be revoked only with the consent of the Secretary of the Treasury or his delegate.

Each potential current beneficiary of the trust is counted as a shareholder for purposes of the proposed 75 shareholder limitation (or if there were no potential current beneficiaries, the trust would be treated as the shareholder). A potential current income beneficiary means any person, with respect to the applicable period, who is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust. Where the trust disposes of all the stock in an S corporation, any person who first became so eligible during the 60 days before the disposition is not treated as a potential current beneficiary.

A qualified subchapter S trust with respect to which an election is in effect or an exempt trust is not eligible to qualify as an electing small business trust.

#### ***Treatment of items relating to S corporation stock***

The portion of the trust which consists of stock in one or more S corporations is treated as a separate trust for purposes of computing the income tax attributable to the S corporation stock held by the trust. The trust is taxed at the highest individual rate (currently, 39.6 percent on ordinary income and 28 percent on net capital gain) on this portion of the trust's income. The taxable income attributable to this portion includes (1) the items of income, loss, or deduction allocated to it as an S corporation shareholder under the rules of subchapter S, (2) gain or loss from the sale of the S corporation stock, and (3) to the extent provided in regulations, any state or local income taxes and administrative expenses of the trust properly allocable to the S corporation stock. Otherwise allowable capital losses are allowed only to the extent of capital gains.

In computing the trust's income tax on this portion of the trust, no deduction is allowed for amounts distributed to beneficiaries, and no deduction or credit is allowed for any item other than the items described above. This income is not included in the distributable net income of the trust, and thus is not included in the beneficiaries' income. No item relating to the S corporation stock could be apportioned to any beneficiary.

On the termination of all or any portion of an electing small business trust the loss carryovers or excess deductions referred to in section 642(h) is taken into account by the entire trust, subject to the usual rules on termination of the entire trust.

#### ***Treatment of remainder of items held by trust***

In determining the tax liability with regard to the remaining portion of the trust, the items taken into account by the subchapter S portion of the trust are disregarded. Although distributions from the trust are deductible in computing the taxable income on this portion of the trust, under the usual rules of subchapter J, the trust's distributable net income does not include any income attributable to the S corporation stock.

***Termination of trust and conforming amendment applicable to all trusts***

Where the trust terminates before the end of the S corporation's taxable year, the trust takes into account its pro rata share of S corporation items for its final year. The bill makes a conforming amendment applicable to all trusts and estates clarifying that this is the present-law treatment of trusts and estates that terminate before the end of the S corporation's taxable year.

***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

**3. Expansion of post-death qualification for certain trusts (sec. 1303 of the bill and sec. 1361 of the Code)**

***Present Law***

Under present law, trusts other than grantor trusts, voting trusts, certain testamentary trusts and "qualified subchapter S trusts" may not be shareholders in a S corporation. A grantor trust may remain an S corporation shareholder for 60 days after the death of the grantor. The 60-day period is extended to 2 years if the entire corpus of the trust is includable in the gross estate of the deemed owner. In addition, a trust may be an S corporation shareholder for 60 days after the transfer of S corporation pursuant to a will.

***Reasons for Change***

The Committee believes that the 60-day holding period applicable to certain testamentary trusts should be expanded to facilitate estate administration.

***Explanation of Provision***

The provision expands the post-death holding period to 2 years for all testamentary trusts.

***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

**4. Financial institutions permitted to hold safe harbor debt (sec. 1304 of the bill and sec. 1361 of the Code)**

***Present Law***

A small business corporation eligible to be an S corporation may not have more than one class of stock. Certain debt ("straight debt") is not treated as a second class of stock so long as such debt is an unconditional promise to pay on demand or on a specified date a sum certain in money if: (1) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors; (2) there is no convertibility (directly or in-

directly) into stock, and (3) the creditor is an individual (other than a nonresident alien), an estate, or certain qualified trusts.

### ***Reasons for Change***

The Committee believes that bona fide debt should not be excluded from the subchapter S safe harbor simply because the debt is held by a financial institution.

### ***Explanation of Provision***

The definition of “straight debt” is expanded to include debt held by creditors, other than individuals, that are actively and regularly engaged in the business of lending money.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **5. Rules relating to inadvertent terminations and invalid elections (sec. 1305 of the bill and sec. 1362 of the Code)**

### ***Present Law***

Under present law, if the Internal Revenue Service (“IRS”) determines that a corporation’s Subchapter S election is inadvertently terminated, the IRS can waive the effect of the terminating event for any period if the corporation timely corrects the event and if the corporation and shareholders agree to be treated as if the election had been in effect for that period. Such waivers generally are obtained through the issuance of a private letter ruling. Present law does not grant the IRS the ability to waive the effect of an inadvertent invalid Subchapter S election.

In addition, under present law, a small business corporation must elect to be an S corporation no later than the 15th day of the third month of the taxable year for which the election is effective. The IRS may not validate a late election.

### ***Reasons for Change***

The Committee believes that the Secretary of the Treasury should have the same authority to validate inadvertently defective subchapter S elections as it has for inadvertent subchapter S terminations.

### ***Explanation of Provision***

Under the provision, the authority of the IRS to waive the effect of an inadvertent termination is extended to allow the Service to waive the effect of an invalid election caused by an inadvertent failure to qualify as a small business corporation or to obtain the required shareholder consents (including elections regarding qualified subchapter S trusts), or both. The provision also allows the IRS to treat a late Subchapter S election as timely where the Service determines that there was reasonable cause for the failure to make the election timely. The IRS may exercise this authority in cases where the taxpayer never filed an election. It is intended that the

IRS be reasonable in exercising this authority and apply standards that are similar to those applied under present law to inadvertent subchapter S terminations and other late or invalid elections.

***Effective Date***

The provision applies to taxable years beginning after December 31, 1982.<sup>3</sup>

**6. Agreement to terminate year (sec. 1306 of the bill and sec. 1377 of the Code)**

***Present Law***

In general, each item of S corporation income, deduction and loss is allocated to shareholders on a per-share, per-day basis. However, if any shareholder terminates his or her interest in an S corporation during a taxable year, the S corporation, with the consent of all its shareholders, may elect to allocate S corporation items by closing its books as of the date of such termination rather than apply the per-share, per-day rule.

***Reasons for Change***

The Committee believes that the election to close the books of an S corporation does not need the consent of a shareholder whose tax liability is unaffected by the election.

***Explanation of Provision***

The provision provides that, under regulations to be prescribed by the Secretary of the Treasury, the election to close the books of the S corporation upon the termination of a shareholder's interest is made by all affected shareholders and the corporation, rather than by all shareholders. The closing of the books applies only to the affected shareholders. For this purpose, "affected shareholders" means any shareholder whose interest is terminated and all shareholders to whom such shareholder has transferred shares during the year. If a shareholder transferred shares to the corporation, "affected shareholders" includes all persons who were shareholders during the year.

***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

**7. Expansion of post-termination transition period (sec. 1307 of the bill and secs. 1377 and 6037 of the Code)**

***Present Law***

Distributions made by a former S corporation during its post-termination period are treated in the same manner as if the distributions were made by an S corporation (e.g., treated by shareholders as nontaxable distributions to the extent of the accumulated ad-

<sup>3</sup>This is the effective date of the present-law provision regarding inadvertent terminations.



justment account). Distributions made after the post-termination period are generally treated as made by a C corporation (i.e., treated by shareholders as taxable dividends to the extent of earnings and profits).

The “post-termination period” is the period beginning on the day after the last day of the last taxable year of the S corporation and ending on the later of: (1) a date that is one year later, or (2) the due date for filing the return for the last taxable year and the 120-day period beginning on the date of a determination that the corporation’s S corporation election had terminated for a previous taxable year.

In addition, the audit procedures adopted by the Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”) with respect to partnerships also apply to S corporations. Thus, the tax treatment of items is determined at the corporate, rather than individual level.

### ***Reasons for Change***

The Committee believes that the current scope of the “post-termination period” is insufficient under present law. In addition, the Committee believes that the TEFRA audit procedures should be inapplicable to entities with a limited number of owners.

### ***Explanation of Provision***

The present-law definition of post-termination period is expanded to include the 120-day period beginning on the date of any determination pursuant to an audit of the taxpayer that follows the termination of the S corporation’s election and that adjusts a subchapter S item of income, loss or deduction of the S corporation during the S period. In addition, the definition of “determination” is expanded to include a final disposition of the Secretary of the Treasury of a claim for refund and, under regulations, certain agreements between the Secretary and any person, relating to the tax liability of the person.

In addition, the provision repeals the TEFRA audit provisions applicable to S corporations and provides other rules to require consistency between the returns of the S corporation and its shareholders.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **8. S corporations permitted to hold subsidiaries (sec. 1308 of the bill and secs. 1361 and 1362 of the Code)**

### ***Present Law***

A small business corporation may not be a member of an affiliated group of corporations (other than by reason of ownership in certain inactive corporations). Thus, an S corporation may not own 80 percent or more of the stock of another corporation (whether an S corporation or a C corporation).

In addition, a small business corporation may not have as a shareholder another corporation (whether an S corporation or a C corporation).

### ***Reasons for Change***

The Committee understands that there are situations where taxpayers may wish to separate different trades or businesses in different corporate entities. The Committee believes that, in such situations, shareholders should be allowed to arrange these separate corporate entities under parent-subsidary arrangements as well as brother-sister arrangements.

### ***Explanation of Provision***

#### ***C corporation subsidiaries***

An S corporation is allowed to own 80 percent or more of the stock of a C corporation. The C corporation subsidiary could elect to join in the filing of a consolidated return with its affiliated C corporations. An S corporation is not allowed to join in such election. Dividends received by an S corporation from a C corporation in which the S corporation has an 80 percent or greater ownership stake is not treated as passive investment income for purposes of sections 1362 and 1375 to the extent the dividends are attributable to the earnings and profits of the C corporation derived from the active conduct of a trade or business.

#### ***S corporation subsidiaries***

In addition, an S corporation is allowed to own a qualified subchapter S subsidiary. The term “qualified subchapter S subsidiary” means a domestic corporation that is not an ineligible corporation (i.e., a corporation that would be eligible to be an S corporation if the stock of the corporation were held directly by the shareholders of its parent S corporation) if (1) 100 percent of the stock of the subsidiary were held by its S corporation parent and (2) for which the parent elects to treat as a qualified subchapter S subsidiary. If a subsidiary ceases to be a qualified S corporation subsidiary (either because the subsidiary fails to qualify or the parent revokes the election) another such election may not be made for the subsidiary by the parent for five years without the consent of the Secretary of the Treasury.

Under the election, the qualified subchapter S subsidiary is not treated as a separate corporation and all the assets, liabilities, and items of income, deduction, and credit of the subsidiary are treated as the assets, liabilities, and items of income, deduction, and credit of the parent S corporation. Thus, transactions between the S corporation parent and qualified S corporation subsidiary are not taken into account and items of the subsidiary (including accumulated earnings and profits, passive investment income, built-in gains, etc.) are considered to be items of the parent. In addition, if a subsidiary ceases to be a qualified subchapter S subsidiary (e.g., fails to meet the wholly-owned requirement), the subsidiary will be treated as a new corporation acquiring all of its assets (and

assuming all of its liabilities) immediately before such cessation from the parent S corporation in exchange for its stock.<sup>4</sup>

Under the provision, if an election is made to treat an existing corporation (whether or not its stock was acquired from another person or previously held by the S corporation) as a qualified subchapter S subsidiary, the subsidiary will be deemed to have liquidated under sections 332 and 337 immediately before the election is effective. The built-in gains tax under section 1374 and the LIFO recapture tax under section 1363(d) may apply where the subsidiary was previously a C corporation. Where the stock of the subsidiary was acquired by the S corporation in a qualified stock purchase, an election under section 338 with respect to the subsidiary may be made.

Because the parent and each subsidiary corporation that is a qualified subchapter S subsidiary are treated for Federal income tax purposes as a single corporation, debt issued by a subsidiary to a shareholder of the parent corporation will be treated as debt of the parent for purposes of determining the amount of losses that may flow through to shareholders of the parent corporation under section 1366(d)(1)(B). The Secretary of the Treasury may prescribe rules as to the order that losses pass through where debt of both the parent and subsidiary corporations are held by shareholders of the parent. To the extent a shareholder of the parent S corporation is not at-risk with respect to losses of a subsidiary, the at-risk rules of section 465 may cause losses of the subsidiary to be suspended.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **9. Treatment of distributions during loss years (sec. 1309 of the bill and secs. 1366 and 1368 of the Code)**

### ***Present Law***

Under present law, the amount of loss an S corporation shareholder may take into account for a taxable year cannot exceed the sum of the shareholder's adjusted basis in his or her stock of the corporation and the adjusted basis in any indebtedness of the corporation to the shareholder. Any excess loss is carried forward.

Any distribution to a shareholder by an S corporation generally is tax-free to the shareholder to the extent of the shareholder's adjusted basis of his or her stock. The shareholder's adjusted basis is reduced by the tax-free amount of the distribution. Any distribution in excess of the shareholder's adjusted basis is treated as gain from the sale or exchange of property.

Under present law, income (whether or not taxable) and expenses (whether or not deductible) serve, respectively, to increase and decrease an S corporation shareholder's basis in the stock of the corporation. These rules require that the adjustments to basis

<sup>4</sup> Similar rules apply with respect to wholly owned subsidiaries of real estate investment trusts (REITs) under section 856(i) of present law.

for items of both income and loss for any taxable year apply before the adjustment for distributions applies.<sup>5</sup>

These rules limiting losses and allowing tax-free distributions up to the amount of the shareholder's adjusted basis are similar in certain respects to the rules governing the treatment of losses and cash distributions by partnerships. Under the partnership rules (unlike the S corporation rules), for any taxable year, a partner's basis is first increased by items of income, then decreased by distributions, and finally is decreased by losses for that year.<sup>6</sup>

In addition, if the S corporation has accumulated earnings and profits,<sup>7</sup> any distribution in excess of the amount in an "accumulated adjustments account" will be treated as a dividend (to the extent of the accumulated earnings and profits). A dividend distribution does not reduce the adjusted basis of the shareholder's stock. The "accumulated adjustments account" generally is the amount of the accumulated undistributed post-1982 gross income less deductions.

### ***Reasons for Change***

The Committee believes that the rules regarding the treatment of distributions by S corporations during loss years should be the same as the rules applicable to partnerships.

### ***Explanation of Provision***

The provision provides that the adjustments for distributions made by an S corporation during a taxable year are taken into account before applying the loss limitation for the year. Thus, distributions during a year reduce the adjusted basis for purposes of determining the allowable loss for the year, but the loss for a year does not reduce the adjusted basis for purposes of determining the tax status of the distributions made during that year.

The provision also provides that in determining the amount in the accumulated adjustment account for purposes of determining the tax treatment of distributions made during a taxable year by an S corporation having accumulated earnings and profits, net negative adjustments (i.e., the excess of losses and deductions over income) for that taxable year are disregarded.

The following examples illustrate the application of these provisions:

*Example 1.*—X is the sole shareholder of corporation A, a calendar year S corporation with no accumulated earnings and profits. X's adjusted basis in the stock of A on January 1, 1998, is \$1,000 and X holds no debt of A. During 1998, A makes a distribution to X of \$600, recognizes a capital gain of \$200 and sustains an operating loss of \$900. Under the bill, X's adjusted basis in the A stock is increased to \$1,200 (\$1,000 plus \$200 capital gain recognized) pursuant to section 1368(d) to determine the effect of the distribution. X's adjusted basis is then reduced by the amount of the distribution to \$600 (\$1,200 less \$600) to determine the application of

<sup>5</sup>See section 1368(d)(1); H. Rept. 97-826, p. 17; S. Rept. 97-640, p. 18; Treas. Reg. sec. 1.1367-1(e).

<sup>6</sup>Treas. Reg. sec. 1.704-1(d)(2); Rev. Rul. 66-94, 1966-1 C.B. 166.

<sup>7</sup>An S corporation may have earnings and profits from years prior to its subchapter S election or from pre-1983 subchapter S years.

the loss limitation of section 1366(d)(1). X is allowed to take into account \$600 of A's operating loss, which reduces X's adjusted basis to zero. The remaining \$300 loss is carried forward pursuant to section 1366(d)(2).

*Example 2.*—The facts are the same as in Example 1, except that on January 1, 1998, A has accumulated earnings and profits of \$500 and an accumulated adjustments account of \$200. Under the bill, because there is a net negative adjustment for the year, no adjustment is made to the accumulated adjustments account before determining the effect of the distribution under section 1368(c).

As to A, \$200 of the \$600 distribution is a distribution of A's accumulated adjustments account, reducing the accumulated adjustments account to zero. The remaining \$400 of the distribution is a distribution of accumulated earnings and profits ("E & P") and reduces A's E & P to \$100. A's accumulated adjustments account is then increased by \$200 to reflect the recognized capital gain and reduced by \$900 to reflect the operating loss, leaving a negative balance in the accumulated adjustment account on January 1, 1999, of \$700 (zero plus \$200 less \$900).

As to X, \$200 of the distribution is applied against X's adjusted basis of \$1,200 (\$1,000 plus \$200 capital gain recognized), reducing X's adjusted basis to \$1,000. The remaining \$400 of the distribution is taxable as a dividend and does not reduce X's adjusted basis. Because X's adjusted basis is \$1,000, the loss limitation does not apply to X, who may deduct the entire \$900 operating loss. X's adjusted basis is then decreased to reflect the \$900 operating loss. Accordingly, X's adjusted basis on January 1, 1999, is \$100 (\$1,000 plus \$200 less \$900).

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **10. Treatment of S corporations under subchapter C (sec. 1310 of the bill and sec. 1371 of the Code)**

### ***Present Law***

Present law contains several provisions relating to the treatment of S corporations as corporations generally for purposes of the Internal Revenue Code.

First, under present law, the taxable income of an S corporation is computed in the same manner as in the case of an individual (sec. 1363(b)). Under this rule, the provisions of the Code governing the computation of taxable income which are applicable only to corporations, such as the dividends received deduction, do not apply to S corporations.

Second, except as otherwise provided by the Internal Revenue Code and except to the extent inconsistent with subchapter S, subchapter C (i.e., the rules relating to corporate distributions and adjustments) applies to an S corporation and its shareholders (sec. 1371(a)(1)). Under this second rule, provisions such as the corporate reorganization provisions apply to S corporations. Thus, a C corporation may merge into an S corporation tax-free.

Finally, an S corporation in its capacity as a shareholder of another corporation is treated as an individual for purposes of subchapter C (sec. 1371(a)(2)). In 1988, the Internal Revenue Service took the position that this rule prevents the tax-free liquidation of a C corporation into an S corporation because a C corporation cannot liquidate tax-free when owned by an individual shareholder.<sup>8</sup> In 1992, the Internal Revenue Service reversed its position, stating that the prior ruling was incorrect.<sup>9</sup>

### ***Reasons for Change***

The Committee wishes to clarify that the position taken by the Internal Revenue Service in 1992 that allows the tax-free liquidation of a C corporation into an S corporation represents the proper policy.

### ***Explanation of Provision***

The provision repeals the rule that treats an S corporation in its capacity as a shareholder of another corporation as an individual. Thus, the provision clarifies that the liquidation of a C corporation into an S corporation will be governed by the generally applicable subchapter C rules, including the provisions of sections 332 and 337 allowing the tax-free liquidation of a corporation into its parent corporation. Following a tax-free liquidation, the built-in gains of the liquidating corporation may later be subject to tax under section 1374 upon a subsequent disposition. An S corporation also will be eligible to make a section 338 election (assuming all the requirements are otherwise met), resulting in immediate recognition of all the acquired C corporation's gains and losses (and the resulting imposition of a tax).

The repeal of this rule does not change the general rule governing the computation of income of an S corporation. For example, it does not allow an S corporation, or its shareholders, to claim a dividends received deduction with respect to dividends received by the S corporation, or to treat any item of income or deduction in a manner inconsistent with the treatment accorded to individual taxpayers.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **11. Elimination of certain earnings and profits (sec. 1311 of the bill and secs. 1362 and 1375 of the Code)**

### ***Present Law***

Under present law, the accumulated earnings and profits of a corporation are not increased for any year in which an election to be treated as an S corporation is in effect. However, under the subchapter S rules in effect before revision in 1982, a corporation electing subchapter S for a taxable year increased its accumulated earn-

<sup>8</sup>PLR 8818049 (Feb. 10, 1988).

<sup>9</sup>PLR 9245004 (July 28, 1992).

ings and profits if its earnings and profits for the year exceeded both its taxable income for the year and its distributions out of that year's earnings and profits. As a result of this rule, a shareholder may later be required to include in his or her income the accumulated earnings and profits when it is distributed by the corporation. The 1982 revision to subchapter S repealed this rule for earnings attributable to taxable years beginning after 1982 but did not do so for previously accumulated S corporation earnings and profits.

### ***Reasons for Change***

The Committee believes that the existence of pre-1983 earnings and profits of an S corporation unnecessarily complicates corporate recordkeeping and constitutes a potential trap for the unwary.

### ***Explanation of Provision***

The provision provides that if a corporation is an S corporation for its first taxable year beginning after December 31, 1996, the accumulated earnings and profits of the corporation as of the beginning of that year is reduced by the accumulated earnings and profits (if any) accumulated in any taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S. Thus, such a corporation's accumulated earnings and profits are solely attributable to taxable years for which an S election was not in effect. This rule is generally consistent with the change adopted in 1982 limiting the S shareholder's taxable income attributable to S corporation earnings to his or her share of the taxable income of the S corporation.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

## **12. Carryover of disallowed losses and deductions under at-risk rules (sec. 1312 of the bill and sec. 1366 of the Code)**

### ***Present Law***

Under section 1366, the amount of loss an S corporation shareholder may take into account cannot exceed the sum of the shareholder's adjusted basis in his or her stock of the corporation and the unadjusted basis in any indebtedness of the corporation to the shareholder. Any disallowed loss is carried forward to the next taxable year. Any loss that is disallowed for the last taxable year of the S corporation may be carried forward to the post-termination period. The "post-termination period" is the period beginning on the day after the last day of the last taxable year of the S corporation and ending on the later of: (1) a date that is one year later, or (2) the due date for filing the return for the last taxable year and the 120-day period beginning on the date of a determination that the corporation's S corporation election had terminated for a previous taxable year.

In addition, under section 465, a shareholder of an S corporation may not deduct losses that are flowed through from the corporation to the extent the shareholder is not "at-risk" with respect to the

loss. Any loss not deductible in one taxable year because of the at-risk rules is carried forward to the next taxable year.

### ***Reasons for Change***

The Committee believes that losses suspended by the at-risk rules should be conformed to the treatment of losses suspended by the subchapter S basis rules.

### ***Explanation of Provision***

Losses of an S corporation that are suspended under the at-risk rules of section 465 are carried forward to the S corporation's post-termination period.

### ***Effective Date***

The provision applies to taxable years beginning after December 31, 1996.

### **13. Adjustments to basis of inherited S stock to reflect certain items of income (sec. 1313 of the bill and sec. 1367 of the Code)**

#### ***Present Law***

Income in respect to a decedent ("IRD") generally consists of items of gross income that accrued during the decedent's lifetime but were not includible in the decedent's income before his or her death under his or her method of accounting. IRD is includible in the income of the person acquiring the right to receive such item. A deduction for the estate tax attributable to an item of IRD is allowed to such person (sec. 691(c)). The cost or basis of property acquired from a decedent is its fair market value at the date of death (or alternate valuation date if that date is elected for estate tax purposes). This basis is often referred to as a "stepped-up basis." Property that constitutes a right to receive IRD does not receive a stepped-up basis.

The basis of a partnership interest or corporate stock acquired from a decedent generally is stepped-up at death. Under Treasury regulations, the basis of a partnership interest acquired from a decedent is reduced to the extent that its value is attributable to items constituting IRD (Treas. reg. sec. 1.742-1). This rule insures that the items of IRD held by a partnership are not later offset by a loss arising from a stepped-up basis. Although S corporation income is taxed to its shareholders in a manner similar to the taxation of a partnership and its partners, no comparable regulation requires a reduction in the basis of stock in an S corporation acquired from a decedent where the S corporation holds items of IRD.

### ***Reasons for Change***

The Committee believes that the present-law treatment of IRD items of an S corporation is unclear and that the treatment of such items should be similar to the treatment of identical items held by a partnership.



### ***Explanation of Provision***

The provision provides that a person acquiring stock in an S corporation from a decedent would treat as IRD his or her pro rata share of any item of income of the corporation that would have been IRD if that item had been acquired directly from the decedent. Where an item is treated as IRD, a deduction for the estate tax attributable to the item generally will be allowed under the provisions of section 691(c). The stepped-up basis in the stock in an S corporation acquired from a decedent is reduced by the extent to which the value of the stock is attributable to items consisting of IRD. This basis rule is comparable to the present-law partnership rule.

### ***Effective Date***

The provision applies with respect to decedents dying after the date of enactment.

## **14. S corporations eligible for rules applicable to real property subdivided for sale by noncorporate taxpayers (sec. 1314 of the bill and sec. 1237 of the Code)**

### ***Present Law***

Under present-law section 1237, a lot or parcel of land held by a taxpayer other than a corporation generally is not treated as ordinary income property solely by reason of the land being subdivided if (1) such parcel had not previously been held as ordinary income property and if in the year of sale, the taxpayer did not hold other real property; (2) no substantial improvement has been made on the land by the taxpayer, a related party, a lessee, or a government; and (3) the land has been held by the taxpayer for five years.

### ***Reasons for Change***

The Committee believes that rules generally applicable to individuals should be applicable to S corporations.

### ***Explanation of Provision***

The provision allows the present-law capital gains presumption in the case of land held by an S corporation. It is expected that rules similar to the attribution rules for partnerships will apply to S corporation (Treas. reg. sec. 1.1237-1(b)(3)).

### ***Effective Date***

The provision is effective for sales in taxable years beginning after December 31, 1996.

## **15. Reelecting subchapter S status (sec. 1315 of the bill and sec. 1362 of the Code)**

### ***Present Law***

A small business corporation that terminates its subchapter S election (whether by revocation or otherwise) may not make an-

other election to be an S corporation for five taxable years unless the Secretary of the Treasury consents to such election.

### ***Reasons for Change***

The Committee believes that, given the changes made by the Committee to subchapter S, it is appropriate to allow corporations that terminated their elections under subchapter S within the last five years to re-elect subchapter S status without the consent of the Secretary.

### ***Explanation of Provision***

For purposes of the five-year rule, any termination of subchapter S status in effect immediately before the date of enactment of the proposal is not to be taken into account. Thus, any small business corporation that had terminated its S corporation election within the five-year period before the date of enactment may re-elect subchapter S status upon enactment of the bill without the consent of the Secretary of the Treasury.

### ***Effective Date***

The provision is effective for terminations occurring in taxable year beginning before January 1, 1997.

## **PENSION SIMPLIFICATION PROVISIONS; FOREIGN SIMPLIFICATION**

### **A. Simplified Distribution Rules (secs. 1401–1404 of the bill and secs. 72(d), 101(b), 401(a)(9), and 402(d) of the Code)**

#### ***Present Law***

In general, a distribution of benefits from a tax-favored retirement arrangement (i.e., a qualified plan, a qualified annuity plan, and a tax-sheltered annuity contract (sec. 403(b) annuity)) generally is includable in gross income in the year it is paid or distributed under the rules relating to the taxation of annuities.

#### ***Lump-sum distributions***

Lump-sum distributions from qualified plans and qualified annuity plans are eligible for special 5-year forward averaging. In general, a lump-sum distribution is a distribution within one taxable year of the balance to the credit of an employee that becomes payable to the recipient first, on account of the death of the employee, second, after the employee attains age 59½, third, on account of the employee's separation from service, or fourth, in the case of self-employed individuals, on account of disability. Lump-sum treatment is not available for distributions from a tax-sheltered annuity.

A taxpayer is permitted to make an election with respect to a lump-sum distribution received on or after the employee attains age 59½ to use 5-year forward income averaging under the tax rates in effect for the taxable year in which the distribution is made. In general, this election allows the taxpayer to pay a separate tax on the lump-sum distribution that approximates the tax that would be due if the lump-sum distribution were received in 5

equal installments. If the election is made, the taxpayer is entitled to deduct the amount of the lump-sum distribution from gross income. Only one such election on or after age 59½ may be made with respect to any employee.

### ***\$5,000 exclusion for employer-provided death benefits***

Under present law, the beneficiary or estate of a deceased employee generally can exclude up to \$5,000 in benefits paid by or on behalf of an employer by reason of the employee's death (sec. 101(b)).

### ***Recovery of basis***

Amounts received as an annuity under a qualified plan generally are includible in income in the year received, except to the extent they represent the return of the recipient's investment in the contract (i.e., basis). Under present law, a pro-rata basis recovery rule generally applies, so that the portion of any annuity payment that represents nontaxable return of basis is determined by applying an exclusion ratio equal to the employee's total investment in the contract divided by the total expected payments over the term of the annuity.

Under a simplified alternative method provided by the IRS, the taxable portion of qualifying annuity payments is determined under a simplified exclusion ratio method.

In no event can the total amount excluded from income as nontaxable return of basis be greater than the recipient's total investment in the contract.

### ***Required distributions***

Present law provides uniform minimum distribution rules generally applicable to all types of tax-favored retirement vehicles, including qualified plans and annuities, IRAs, and tax-sheltered annuities.

Under present law, a qualified plan is required to provide that the entire interest of each participant will be distributed beginning no later than the participant's required beginning date (sec. 401(a)(9)). The required beginning date is generally April 1 of the calendar year following the calendar year in which the plan participant or IRA owner attains age 70½. In the case of a governmental plan or a church plan, the required beginning date is the later of first, such April 1, or second, the April 1 of the year following the year in which the participant retires.

### ***Reasons for Change***

In almost all cases, the responsibility for determining the tax liability associated with a distribution from a qualified plan, tax-sheltered annuity, or IRA rests with the individual receiving the distribution. Under present law, this task can be burdensome. Among other things, the taxpayer must consider (1) whether special tax rules apply that reduce the tax that otherwise would be paid, (2) the amount of the taxpayer's basis in the plan, annuity, or IRA and the rate at which such basis is to be recovered, and (3) whether or not a portion of the distribution is excludable from income as a death benefit.

The number of special rules for taxing pension distributions makes it difficult for taxpayers to determine which method is best for them and also increases the likelihood of error. In addition, the specifics of each of the rules create complexity. For example, the present-law rules for determining the rate at which a participant's basis in a qualified plan is recovered often entail calculations that the average participant has difficulty performing. These rules require a fairly precise estimate of the period over which benefits are expected to be paid. The IRS publication on taxation of pension distributions (Publication 939) contains over 60 pages of actuarial tables used to determine total expected payments.

The original intent of the income averaging rules for pension distributions was to prevent a bunching of taxable income because a taxpayer received all of the benefits in a qualified plan in a single taxable year. Liberalization of the rollover rules in the Unemployment Compensation Amendments of 1992 increased taxpayers' ability to determine the time of the income inclusion of pension distributions, and eliminates the need for special rules such as 5-year forward income averaging to prevent bunching of income.

It is inappropriate to require all participants to commence distributions by age 70½ without regard to whether the participant is still employed by the employer. However, the accrued benefit of employees who retire after age 70½ generally should be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits.

### ***Explanation of Provisions***

#### ***Lump-sum distributions***

The bill repeals 5-year averaging for lump-sum distributions from qualified plans. Thus, the bill repeals the separate tax paid on a lump-sum distribution and also repeals the deduction from gross income for taxpayers who elect to pay the separate tax on a lump-sum distribution. The bill preserves the transition rules adopted in the Tax Reform Act of 1986.

#### ***\$5,000 exclusion for employer-provided death benefits***

The bill repeals the \$5,000 exclusion for employer-provided death benefits.

#### ***Recovery of basis***

The bill provides that basis recovery on payments from qualified plans generally is determined under a method similar to the present-law simplified alternative method provided by the IRS. The portion of each annuity payment that represents a return of basis equals to the employee's total basis as of the annuity starting date, divided by the number of anticipated payments under the following table:

<i>Age</i>	<i>Number of payments:</i>
Not more than 55 .....	360
56–60 .....	310
61–65 .....	260
66–70 .....	210
More than 70 .....	160

### ***Required distributions***

The bill modifies the rule that requires all participants in qualified plans to commence distributions by age 70½ without regard to whether the participant is still employed by the employer and generally replaces it with the rule in effect prior to the Tax Reform Act of 1986. Under the bill, distributions generally are required to begin by April 1 of the calendar year following the later of first, the calendar year in which the employee attains age 70½ or second, the calendar year in which the employee retires. However, in the case of a 5-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5-percent owner attains age 70½.

In addition, in the case of an employee (other than a 5-percent owner) who retires in a calendar year after attaining age 70½, the bill generally requires the employee's accrued benefit to be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan. Thus, under the bill, the employee's accrued benefit is required to reflect the value of benefits that the employee would have received if the employee had retired at age 70½ and had begun receiving benefits at that time.

The actuarial adjustment rule and the rule requiring 5-percent owners to begin distributions after attainment of age 70½ does not apply, under the bill, in the case of a governmental plan or church plan.

### ***Effective Date***

#### ***Lump-sum distributions***

The provision is effective for taxable years beginning after December 31, 1998.

#### ***\$5,000 exclusion for employer-provided death benefits***

The provision applies with respect to decedents dying after date of enactment.

#### ***Recovery of basis***

The provision is effective with respect to annuity starting dates beginning 90 days after the date of enactment.

#### ***Required distributions***

The provision is effective for years beginning after December 31, 1996. Under the provision, the Committee intends that a plan (or an annuity contract) could permit, but is not required to permit participants who have already begun to receive distributions but do not have to under the provision, to stop receiving distributions until such distributions are required under the provision.

## **B. Increased Access to Pension Plans**

### **1. Establish SIMPLE retirement plans (secs. 1421–1422 of the bill and secs. 401(k) and 408(p) of the Code)**

#### ***Present Law***

Present law does not contain rules relating to SIMPLE retirement plans. However, present law does provide a number of ways in which individuals can save for retirement on a tax-favored basis. These include employer-sponsored retirement plans that meet the requirements of the Internal Revenue Code (a “qualified plan”) and individual retirement arrangements (“IRAs”). Employees can earn significant retirement benefits under employer-sponsored retirement plans. However, in order to receive tax-favored treatment, such plans must comply with a variety of rules, including complex nondiscrimination and administrative rules (including top-heavy rules). Such plans are also subject to certain requirements under the labor law provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”).

IRAs are not subject to the same rules as qualified plans, but the amount that can be contributed in any year is significantly less. The maximum deductible IRA contribution for a year is limited to \$2,000. Distributions from IRAs and employer-sponsored retirement plans are generally taxable when made. In addition, distributions prior to age 59½ generally are subject to an additional 10-percent early withdrawal tax.

Contributions to an IRA can also be made by an employer at the election of an employee under a salary reduction simplified employee pension (“SARSEP”). Under SARSEPs, which are not qualified plans, employees can elect to have contributions made to the SARSEP or to receive the contributions in cash. The amount the employee elects to have contributed to the SARSEP is not currently includible in income. The annual amount an employee can elect to contribute to a SARSEP is limited to \$9,500 for 1996. This dollar limit is indexed for inflation in \$500 increments. The election to have amounts contributed to a SARSEP or received in cash is available only if at least 50 percent of the eligible employees of the employer elect to have amounts contributed to the SARSEP. In addition, such election is available for a taxable year only if the employer maintaining the SARSEP had 25 or fewer eligible employees at all times during the prior taxable year. Elective deferrals under SARSEPs are subject to a special nondiscrimination test.

Under one type of qualified plan that can be maintained by an employer, employees can elect to reduce their taxable compensation and have nontaxable contributions made to the plan. Such contributions are called elective deferrals, and the plans which allow such contributions are called qualified cash or deferred arrangements (or “401(k) plans”). Like SARSEPs, the maximum annual amount of elective deferrals that can be made by an individual is \$9,500 for 1996. A special nondiscrimination test applies to elective deferrals. An employer may make contributions based on an employee’s elective contributions. Such contributions are called matching contributions, and are subject to a special nondiscrimination

test similar to the special nondiscrimination test applicable to elective deferrals.

### ***Reasons for Change***

Retirement plan coverage is lower among small employers than among medium and large employers. The Committee believes that one of the reasons small employers do not establish tax-qualified retirement plans is the complexity of rules relating to such plans and the cost of complying with such rules. The Committee believes it is appropriate to encourage small employers to adopt retirement plans by providing a simplified retirement plan that is not subject to the complex rules applicable to tax-qualified plans.

Among the rules applicable to tax-qualified plans are nondiscrimination rules that help to ensure that plans cover a broad range of employees, not just an employer's highly compensated employees. The Committee believes that the goal of the nondiscrimination rules, broad pension coverage, is an important one. Unfortunately, the complicated nature of these rules may prevent small employers from establishing any plan. The Committee believes that the purposes of the nondiscrimination rules will be served in the case of small employers if all full-time employees are given the opportunity to participate in the plan, the employer is required to match employee contributions, and there are limits on the total contributions that can be made.

The Committee believes that employees should be encouraged to save for retirement, and thus believes a penalty should be imposed on amounts withdrawn within a short period after the retirement plan is adopted.

### ***Explanation of Provision***

#### ***In general***

The bill creates a simplified retirement plan for small business called the savings incentive match plan for employees ("SIMPLE") retirement plan. SIMPLE plans can be adopted by employers who employ 100 or fewer employees on any day during the year and who do not maintain another employer-sponsored retirement plan. A SIMPLE plan can be either an IRA for each employee or part of a qualified cash or deferred arrangement ("401(k) plan"). If established in IRA form, a SIMPLE plan is not subject to the nondiscrimination rules generally applicable to qualified plans (including the top-heavy rules) and simplified reporting requirements apply. Within limits, contributions to a SIMPLE plan are not taxable until withdrawn.

A SIMPLE plan can also be adopted as part of a 401(k) plan. In that case, the plan does not have to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules continue to apply.

#### ***SIMPLE retirement plans in IRA form***

##### ***In general***

A SIMPLE retirement plan allows employees to make elective contributions to an IRA. Employee contributions have to be ex-

pressed as a percentage of the employee's compensation, and cannot exceed \$6,000 per year. The \$6,000 dollar limit is indexed for inflation in \$500 increments.

Under the bill, the employer is required to satisfy one of two contribution formulas. Under the matching contribution formula, the employer generally is required to match employee elective contributions on a dollar-for-dollar basis up to 3 percent of the employee's compensation. Under a special rule, the employer could elect a lower percentage matching contribution for all employees (but not less than 1 percent of each employee's compensation). In order for the employer to lower the matching percentage for any year, the employer has to notify employees of the applicable match within a reasonable time before the 30-day election period for the year (described below). In addition, a lower percentage cannot be elected for more than 2 out of any 5 years.

Alternatively, for any year, an employer is permitted to elect, in lieu of making matching contributions, to make a 2 percent of compensation nonelective contribution on behalf of each eligible employee with at least \$5,000 in compensation for such year. If such an election were made, the employer has to notify eligible employees of the change within a reasonable period before the 30-day election period for the year (described below). No contributions other than employee elective contributions and required employer matching contributions (or, alternatively, required employer nonelective contributions) can be made to a SIMPLE account.

Only employers who employ 100 or fewer employees on any day during the year and who do not currently maintain a qualified plan can establish SIMPLE retirement accounts for their employees.

Each employee of the employer who received at least \$5,000 in compensation from the employer during any 2 prior years and who is reasonably expected to receive at least \$5,000 in compensation during the year must be eligible to participate in the SIMPLE plan. Nonresident aliens and employees covered under a collective bargaining agreement do not have to be eligible to participate in the SIMPLE plan. Self-employed individuals can participate in a SIMPLE plan.

All contributions to an employee's SIMPLE account have to be fully vested.

Distributions from a SIMPLE plan generally are taxed as under the rules relating to IRAs, except that an increased early withdrawal tax (25 percent) applies to distributions within the first 2 years the employee first participates in the SIMPLE plan.

#### *Tax treatment of SIMPLE accounts, contributions, and distributions*

Contributions to a SIMPLE account generally are deductible by the employer. In the case of matching contributions, the employer will be allowed a deduction for a year only if the contributions are made by the due date (including extensions) for the employer's tax return. Contributions to a SIMPLE account are excludable from the employee's income. SIMPLE accounts, like IRAs, are not subject to tax. Distributions from a SIMPLE retirement account generally are taxed under the rules applicable to IRAs. Thus, they are includible in income when withdrawn. Tax-free rollovers can be made from



one SIMPLE account to another. A SIMPLE account can be rolled over to an IRA on a tax-free basis after a two-year period has expired since the individual first participated in the SIMPLE plan. To the extent an employee is no longer participating in a SIMPLE plan (e.g., the employee has terminated employment), the employee's SIMPLE account will be treated as an IRA.

Early withdrawals from a SIMPLE account generally are subject to the 10-percent early withdrawal tax applicable to IRAs. However, withdrawals of contributions during the 2-year period beginning on the date the employee first participated in the SIMPLE plan are subject to a 25-percent early withdrawal tax (rather than 10 percent).

Contributions to a SIMPLE account are not subject to employment taxes or income tax withholding.

#### *Administrative requirements*

Each eligible employee can elect, within the 30-day period before the beginning of any year (or the 30-day period before first becoming eligible to participate), to participate in the SIMPLE plan (i.e., to make elective deferrals), and to modify any previous elections regarding the amount of contributions. An employer is required to contribute employees' elective deferrals to the employee's SIMPLE account within 30 days after the end of the month to which the contributions relate. Employees must be allowed to terminate participation in the SIMPLE plan at any time during the year (i.e., to stop making contributions). The plan can provide that an employee who terminates participation cannot resume participation until the following year. A plan can permit (but is not required to permit) an individual to make other changes to his or her salary reduction contribution election during the year (e.g., reduce contributions). The Committee intends that an employer is permitted to designate a SIMPLE account trustee to which contributions on behalf of eligible employees are made.

#### *Reporting requirements*

*Trustee requirements.*—The trustee of a SIMPLE account is required each year to prepare, and provide to the employer maintaining the SIMPLE plan, a summary description containing the following basic information about the plan: the name and address of the employer and the trustee; the requirements for eligibility; the benefits provided under the plan; the time and method of making salary reduction elections; and the procedures for and effects of, withdrawals (including rollovers) from the SIMPLE account. At least once a year, the trustee is also required to furnish an account statement to each individual maintaining a SIMPLE account. In addition, the trustee is required to file an annual report with the Secretary. A trustee who fails to provide any of such reports or descriptions will be subject to a penalty of \$50 per day until such failure is corrected, unless the failure is due to reasonable cause.

*Employer reports.*—The employer maintaining a SIMPLE plan is required to notify each employee of the employee's opportunity to make salary reduction contributions under the plan as well as the contribution alternative chosen by the employer immediately before the employee becomes eligible to make such election. This notice

must include a copy of the summary description prepared by the trustee. An employer who fails to provide such notice will be subject to a penalty of \$50 per day on which such failure continues, unless the failure is due to reasonable cause.

### *Definitions*

For purposes of the rules relating to SIMPLE plans, compensation means compensation required to be reported by the employer on Form W-2, plus any elective deferrals of the employee. In the case of a self-employed individual, compensation means net earnings from self-employment. The term employer includes the employer and related employers. Related employers includes trades or businesses under common control (whether incorporated or not), controlled groups of corporations, and affiliated service groups. In addition, the leased employee rules apply.

For purposes of the rule prohibiting an employer from establishing a SIMPLE plan, if the employer has another qualified plan, an employer is treated as maintaining a qualified plan if the employer (or a predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, with respect to service for any year in the period beginning with the year the SIMPLE plan became effective and ending with the year for which the determination is being made. A qualified plan includes a qualified retirement plan, a qualified annuity plan, a governmental plan, a tax-sheltered annuity, and a simplified employee pension.

### ***SIMPLE 401(k) plans***

In general, under the bill, a cash or deferred arrangement (i.e., 401(k) plan), will be deemed to satisfy the special nondiscrimination tests applicable to employee elective deferrals and employer matching contributions if the plan satisfies the contribution requirements applicable to SIMPLE plans. In addition, the plan is not subject to the top-heavy rules for any year for which this safe harbor is satisfied. The plan is subject to the other qualified plan rules.

The safe harbor is satisfied if, for the year, the employer does not maintain another qualified plan and (1) employee's elective deferrals are limited to no more than \$6,000, (2) the employer matches employees' elective deferrals up to 3 percent of compensation (or, alternatively, makes a 2 percent of compensation nonelective contribution on behalf of all eligible employees with at least \$5,000 in compensation), and (3) no other contributions are made to the arrangement. Contributions under the safe harbor have to be 100 percent vested. The employer cannot reduce the matching percentage below 3 percent of compensation.

### ***Repeal of SARSEPs***

Under the bill, the present-law rules permitting SARSEPs no longer apply after December 31, 1996, unless the SARSEP was established before January 1, 1997. Consequently, an employer is not permitted to establish a SARSEP after December 31, 1996. SARSEPs established before January 1, 1997, can continue to receive contributions under present-law rules, and new employees of

the employer hired after December 31, 1996, can participate in the SARSEP in accordance with such rules.

***Effective Date***

The provisions relating to SIMPLE plans are effective for years beginning after December 31, 1996.

**2. Tax-exempt organizations eligible under section 401(k) (sec. 1426 of the bill and sec. 401(k) of the Code)**

***Present Law***

Under present law, tax-exempt and State and local government organizations are generally prohibited from establishing qualified cash or deferred arrangements (sec. 401(k) plans). Qualified cash or deferred arrangements (1) of rural cooperatives, (2) adopted by State and local governments before May 6, 1986, or (3) adopted by tax-exempt organizations before July 2, 1986, are not subject to this prohibition.

***Reasons for Change***

Nongovernmental tax-exempt entities should be permitted to maintain qualified cash or deferred arrangements for their employees on the same basis as other employers.

***Explanation of Provision***

The bill allows tax-exempt organizations (including, for this purpose, Indian tribal governments, a subdivision of an Indian tribal government, an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of such entities) to maintain qualified cash or deferred arrangements. The bill retains the present-law prohibition against the maintenance of cash or deferred arrangements by State and local governments, except to the extent it may apply to Indian tribes.

***Effective Date***

The provision is effective for plan years beginning after December 31, 1996.

**C. Nondiscrimination Provisions**

**1. Definition of highly compensated employees and repeal of family aggregation rules (sec. 1431 of the bill and secs. 401(a)(17), 404(l), and 414(g) of the Code)**

***Present Law***

***Definition of highly compensated employee***

An employee, including a self-employed individual, is treated as highly compensated if, at any time during the year or the preceding year, the employee (1) was a 5-percent owner of the employer, (2) received more than \$100,000 (for 1996) in annual compensation

from the employer, (3) received more than \$66,000 (for 1996) in annual compensation from the employer and was one of the top-paid 20 percent of employees during the same year, or (4) was an officer of the employer who received compensation in excess of \$60,000 (for 1996). If, for any year, no officer has compensation in excess of the threshold, then the highest paid officer of the employer is treated as a highly compensated employee.

### ***Family aggregation rules***

A special rule applies with respect to the treatment of family members of certain highly compensated employees for purposes of the nondiscrimination rules applicable to qualified plans. Under the special rule, if an employee is a family member of either a 5-percent owner or 1 of the top-10 highly compensated employees by compensation, then any compensation paid to such family member and any contribution or benefit under the plan on behalf of such family member is aggregated with the compensation paid and contributions or benefits on behalf of the 5-percent owner or the highly compensated employee in the top-10 employees by compensation. Therefore, such family member and employee are treated as a single highly compensated employee. An individual is considered a family member if, with respect to an employee, the individual is a spouse, lineal ascendant or descendant, or spouses of a lineal ascendant or descendant of the employee.

Similar family aggregation rules apply with respect to the \$150,000 (for 1996) limit on compensation that may be taken into account under a qualified plan (sec. 401(a)(17)) and for deduction purposes (sec. 404(1)). However, under such provisions, only the spouse of the employee and lineal descendants of the employee who have not attained age 19 are taken into account.

### ***Reasons for Change***

Under present law, the administrative burden on plan sponsors to determine which employees are highly compensated can be significant. The various categories of highly compensated employees require employers to perform a number of calculations that for many employers have largely duplicative results.

The family aggregation rules impose undue restrictions on the ability of a family-owned small business to provide adequate retirement benefits for all members of the family working for the business. In addition, the complexity of the calculations required under the family aggregation rules appears to be unnecessary in light of the numerous other provisions that ensure that qualified pension plans do not disproportionately favor highly compensated employees.

### ***Explanation of Provisions***

#### ***Definition of highly compensated employee***

Under the bill, an employee is treated as highly compensated if the employee (1) was a 5-percent owner of the employer at any time during the year or the preceding year or (2) had compensation for the preceding year in excess of \$80,000 (indexed for inflation) and the employee was in the top 20 percent of employees by com-

pensation for such year. The bill also repeals the rule requiring the highest paid officer to be treated as a highly compensated employee.

***Family aggregation rules***

The bill repeals the family aggregation rules.

***Effective Date***

The provisions are effective for years beginning after December 31, 1996.

**2. Modification of additional participation requirements  
(sec. 1432 of the bill and sec. 401(a)(26) of the Code)**

***Present Law***

Under present law, a plan is not a qualified plan unless it benefits no fewer than the lesser of (a) 50 employees of the employer or (b) 40 percent of all employees of the employer (sec. 401(a)(26)). This requirement may not be satisfied by aggregating comparable plans, but may be applied separately to different lines of business of the employer. A line of business of the employer does not qualify as a separate line of business unless it has at least 50 employees.

***Reasons for Change***

The minimum participation rule was adopted in the Tax Reform Act of 1986 because the Congress believed that it was inappropriate to permit an employer to maintain multiple plans, each of which covered a very small number of employees. Although plans that are aggregated for nondiscrimination purposes are required to satisfy comparability requirements with respect to the amount of contributions or benefits, such an arrangement may still discriminate in favor of highly compensated employees.

However, it is appropriate to better target the minimum participation rule by limiting the scope of the rule to defined benefit pension plans and increasing the minimum number of employees required to be covered under very small plans.

Also, the arbitrary requirement that a line of business must have at least 50 employees requires application of the minimum participation rule on an employer-wide basis in some cases in which the employer truly has separate lines of business.

***Explanation of Provision***

The bill provides that the minimum participation rule applies only to defined benefit pension plans. In addition, the bill provides that a defined benefit pension plan does not satisfy the rule unless it benefits no fewer than the lesser of (1) 50 employees or (2) the greater of (a) 40 percent of all employees of the employer or (b) 2 employees (1 employee if there is only 1 employee).

The bill provides that the requirement that a line of business has at least 50 employees does not apply in determining whether a plan satisfies the minimum participation rule on a separate line of business basis.

### ***Effective Date***

The provision is effective for years beginning after December 31, 1996.

### **3. Nondiscrimination rules for qualified cash or deferred arrangements and matching contributions (sec. 1433 of the bill and secs. 401(k) and 401(m) of the Code)**

#### ***Present Law***

Under present law, a special nondiscrimination test applies to qualified cash or deferred arrangements (sec. 401(k) plans). The special nondiscrimination test is satisfied if the actual deferral percentage ("ADP") for eligible highly compensated employees for a plan year is equal to or less than either (1) 125 percent of the ADP of all nonhighly compensated employees eligible to defer under the arrangement or (2) the lesser of 200 percent of the ADP of all eligible nonhighly compensated employees or such ADP plus 2 percentage points.

Employer matching contributions and after-tax employee contributions under qualified defined contribution plans are subject to a special nondiscrimination test (the actual contribution percentage ("ACP") test) similar to the special nondiscrimination test applicable to qualified cash or deferred arrangements. Employer matching contributions that satisfy certain requirements can be used to satisfy the ADP test, but, to the extent so used, such contributions cannot be considered when calculating the ACP test.

A plan that would otherwise fail to meet the special nondiscrimination test for qualified cash or deferred arrangements is not treated as failing such test if excess contributions (with allocable income) are distributed to the employee or, in accordance with Treasury regulations, recharacterized as after-tax employee contributions. For purposes of this rule, in determining the amount of excess contributions and the employees to whom they are allocated, the elective deferrals of highly compensated employees are reduced in the order of their actual deferral percentage beginning with those highly compensated employees with the highest actual deferral percentages. A similar rule applies to employer matching contributions.

#### ***Reasons for Change***

The sources of complexity generally associated with the nondiscrimination requirements for qualified cash or deferred arrangements and matching contributions are the recordkeeping necessary to monitor employee elections, the calculations involved in applying the tests, and the correction mechanism, i.e., what to do if the plan fails the tests.

The Committee believes that the complexity of nondiscrimination requirements, particularly after the Tax Reform Act of 1986 changes that imposed a dollar cap on elective deferrals (\$9,500 in 1996), is not justified by the marginal additional participation of rank-and-file employees that might be achieved by the operation of these requirements. The result that the nondiscrimination rules are intended to produce can also be achieved by creating an incen-

tive for employers to provide certain matching contributions or non-elective contributions on behalf of rank-and-file employees. Such contributions should create a sufficient inducement to rank-and-file employee participation. Thus, the Committee believes it is appropriate to provide a design-based safe harbor for qualified cash or deferred arrangements. Plans that satisfy the safe harbors would not have to satisfy the nondiscrimination tests for cash or deferred arrangements.

In addition, the significant simplification that a design-based safe harbor test achieves may reduce the complexity of the qualified cash or deferred arrangement requirements enough to encourage additional employers to establish such plans, thereby expanding employee access to voluntary retirement savings arrangements. The adoption of a nondiscrimination safe harbor that eliminates the testing of actual plan contributions removes a significant administrative burden that may act as a deterrent to employers who would not otherwise set up such a plan. Thus, the adoption of a simpler nondiscrimination test may encourage more employers, particularly small employers, who do not now provide any tax-favored retirement plan for their employees, to set up such plans.

A design-based nondiscrimination test provides certainty to an employer and plan participants that does not exist under present law. Under such a test, an employer will know at the beginning of each plan year whether the plan satisfies the nondiscrimination requirements for the year.

Simplifying the nondiscrimination tests will also reduce administrative burdens for those plans that do not utilize the safe harbor.

### ***Explanation of Provisions***

#### ***Prior-year data***

The bill modifies the special nondiscrimination tests applicable to elective deferrals and employer matching and after-tax employee contributions to provide that the maximum permitted actual deferral percentage (and actual contribution percentage) for highly compensated employees for the year is determined by reference to the actual deferral percentage (and actual contribution percentage) for nonhighly compensated employees for the preceding, rather than the current, year. A special rule applies for the first plan year.

Alternatively, under the bill, an employer is allowed to elect to use the current year actual deferral percentage (and actual contribution percentage). Such an election can be revoked only as provided by the Secretary.

#### ***Safe harbor for cash or deferred arrangements***

The bill provides that a cash or deferred arrangement satisfies the special nondiscrimination tests if the plan satisfies one of two contribution requirements and satisfies a notice requirement.

A plan satisfies the contribution requirements under the safe harbor rule for qualified cash or deferred arrangements if the plan either first, satisfies a matching contribution requirement or second, the employer makes a nonelective contribution to a defined contribution plan of at least 3 percent of an employee's compensation on behalf of each nonhighly compensated employee who is eli-

gible to participate in the arrangement without regard to whether the employee makes elective contributions under the arrangement.

A plan satisfies the matching contribution requirement if, under the arrangement: first, the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective contributions up to 3 percent of compensation and (b) 50 percent of the employee's elective contributions from 3 to 5 percent of compensation; and second, the rate of match with respect to any elective contribution for highly compensated employees is not greater than the rate of match for nonhighly compensated employees.

Alternatively, if the rate of matching contribution with respect to any rate of elective contribution requirement is not equal to the percentages described in the preceding paragraph, the matching contribution requirement will be deemed to be satisfied if first, the rate of an employer's matching contribution does not increase as an employee's rate of elective contribution increases and second, the aggregate amount of matching contributions at such rate of elective contribution at least equals the aggregate amount of matching contributions that would be made if matching contributions satisfied the above percentage requirements. For example, the alternative test will be satisfied if an employer matches 125 percent of an employee's elective contributions up to the first 3 percent of compensation, 25 percent of elective deferrals from 3 to 4 percent of compensation, and provides no match thereafter. However, the alternative test will not be satisfied if an employer matches 80 percent of an employee's elective contributions up to the first 5 percent of compensation. The former example satisfies the alternative test because the employer match does not increase and the aggregate amount of matching contributions at any rate of elective contribution is at least equal to the aggregate amount of matching contributions required under the general safe harbor rule.

Employer matching and nonelective contributions used to satisfy the contribution requirements of the safe harbor rules are required to be nonforfeitable and are subject to the restrictions on withdrawals that apply to an employee's elective deferrals under a qualified cash or deferred arrangement (sec. 401(k)(2)(B) and (C)). It is intended that employer matching and nonelective contributions used to satisfy the contribution requirements of the safe harbor rules can be used to satisfy other qualified retirement plan nondiscrimination rules (except the special nondiscrimination test applicable to employer matching contributions (the ACP test)). So, for example, a cross-tested defined contribution plan that includes a qualified cash or deferred arrangement can consider such employer matching and nonelective contributions in testing.<sup>10</sup>

The notice requirement is satisfied if each employee eligible to participate in the arrangement is given written notice, within a reasonable period before any year, of the employee's rights and obligations under the arrangement.

<sup>10</sup>The Committee intends that if two plans which include qualified cash or deferred arrangements are treated as one plan for purposes of the nondiscrimination and coverage rules, such qualified cash or deferred arrangements will be treated as one qualified cash or deferred arrangement for purposes of the safe harbor rules. In such a case, unless both qualified cash or deferred arrangements satisfied the safe harbor, both qualified cash or deferred arrangements tested together will have to satisfy the ADP and ACP tests.



***Alternative method of satisfying special nondiscrimination test for matching contributions***

The bill provides a safe harbor method of satisfying the special nondiscrimination test applicable to employer matching contributions (the ACP test). Under this safe harbor, a plan is treated as meeting the special nondiscrimination test if first, the plan meets the contribution and notice requirements applicable under the safe harbor method of satisfying the special nondiscrimination requirement for qualified cash or deferred arrangements, and second, the plan satisfies a special limitation on matching contributions.

The limitation on matching contributions is satisfied if: first, the employer matching contributions on behalf of any employee may not be made with respect to employee contributions or elective deferrals in excess of 6 percent of compensation; second, the rate of an employer's matching contribution does not increase as the rate of an employee's contributions or elective deferrals increases; and third, the matching contribution with respect to any highly compensated employee at any rate of employee contribution or elective deferral is not greater than that with respect to an employee who is not highly compensated.

Any after-tax employee contributions made under the qualified cash or deferred arrangement will continue to be tested under the ACP test. Employer matching and nonelective contributions used to satisfy the safe harbor rules for qualified cash or deferred arrangements cannot be considered in calculating such test. However, employer matching and nonelective contributions in excess of the amount required to satisfy the safe harbor rules for qualified cash or deferred arrangements can be taken into account in calculating such test.

***Distribution of excess contributions and excess aggregate contributions***

The bill provides that the total amount of excess contributions (and excess aggregate contributions) is determined as under present law, but the distribution of excess contributions (and excess aggregate contributions) are required to be made on the basis of the amount of contribution by, or on behalf of, each highly compensated employee. Thus, excess contributions (and excess aggregate contributions) are deemed attributable first to those highly compensated employees who have the greatest dollar amount of elective deferrals.

***Effective Date***

The provisions relating to use of prior-year data and the distribution of excess contributions and excess aggregate contributions are effective for years beginning after December 31, 1996. The provisions providing for a safe harbor for qualified cash or deferred arrangements and the alternative method of satisfying the special nondiscrimination test for matching contributions are effective for years beginning after December 31, 1998.

**4. Definition of compensation for purposes of the limits on contributions and benefits (sec. 1434 of the bill and sec. 415 of the Code)**

***Present Law***

Present law imposes limits on contributions and benefits under qualified plans based on the type of plan. For purposes of these limits, present law provides that the definition of compensation generally does not include elective employee contributions to certain employee benefit plans.

***Reasons for Change***

The Committee believes that not treating employee elective contributions as compensation for purposes of the limits on benefits and contributions under qualified plans unduly restricts the amount that employees, particularly employees who are not highly compensated, can earn under qualified plans.

***Explanation of Provision***

The bill provides that elective deferrals to section 401(k) plans and similar arrangements, elective contributions to nonqualified deferred compensation plans of tax-exempt employers and State and local governments (sec. 457 plans), and salary reduction contributions to a cafeteria plan are considered compensation for purposes of the limits on contributions and benefits.

***Effective Date***

The provision is effective for years beginning after December 31, 1997.

**D. Miscellaneous Pension Simplification**

**1. Plans covering self-employed individuals (sec. 1441 of the bill and sec. 401(d) of the Code)**

***Present Law***

Prior to the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), different rules applied to retirement plans maintained by incorporated employers and unincorporated employers (such as partnerships and sole proprietors). In general, plans maintained by unincorporated employers were subject to special rules in addition to the other qualification requirements of the Code. Most, but not all, of this disparity was eliminated by TEFRA. Under present law, certain special aggregation rules apply to plans maintained by owner employees of unincorporated businesses that do not apply to other qualified plans (sec. 401(d)(1) and (2)).

***Reasons for Change***

The remaining special aggregation rules for plans maintained by unincorporated employers are unnecessary and should be eliminated. Applying the same set of rules to all types of plans would make the qualification standards easier to apply and administer.

### ***Explanation of Provision***

The bill eliminates the special aggregation rules that apply to plans maintained by self-employed individuals that do not apply to other qualified plans.

### ***Effective Date***

The provision is effective for years beginning after December 31, 1996.

## **2. Elimination of special vesting rule for multiemployer plans (sec. 1442 of the bill and sec. 411(a) of the Code)**

### ***Present Law***

Under present law, except in the case of multiemployer plans, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the participant's completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent at the end of 4 years of service, 60 percent at the end of 5 years of service, 80 percent at the end of 6 years of service, and 100 percent at the end of 7 years of service.

In the case of a multiemployer plan, a participant's accrued benefit derived from employer contributions is required to be 100-percent vested no later than upon the participant's completion of 10 years of service. This special rule applies only to employees covered by the plan pursuant to a collective bargaining agreement.

### ***Reasons for Change***

The present-law vesting rules for multiemployer plans add to complexity because there are different vesting schedules for different types of plans, and different vesting schedules for persons within the same multiemployer plan. In addition, the present-law rule prevents some workers from earning a pension under a multiemployer plan. Conforming the multiemployer plan rules to the rules for other plans would mean that workers could earn additional benefits.

### ***Explanation of Provision***

The bill conforms the vesting rules for multiemployer plans to the rules applicable to other qualified plans.

### ***Effective Date***

The provision is effective for plan years beginning on or after the earlier of (1) the later of January 1, 1997, or the date on which the last of the collective bargaining agreements pursuant to which the plan is maintained terminates, or (2) January 1, 1999, with respect to participants with an hour of service after the effective date.

### **3. Distributions under rural cooperative plans (sec. 1443 of the bill and sec. 401(k)(7) of the Code)**

#### ***Present Law***

A qualified cash or deferred arrangement can permit withdrawals of employee elective deferrals only after the earlier of (1) the participant's separation from service, death, or disability, (2) termination of the arrangement, or (3) in the case of a profit-sharing or stock bonus plan, the attainment of age 59½ or the occurrence of a hardship of the participant. In the case of a money purchase pension plan, including a rural cooperative plan, withdrawals by participants cannot occur upon attainment of age 59½ or upon hardship.

#### ***Reasons for Change***

It is appropriate to permit qualified cash or deferred arrangements of rural cooperatives to permit distributions to plan participants under the same circumstances as other qualified cash or deferred arrangements. It is also appropriate to clarify that certain public utility districts and a national association of rural cooperatives should be treated as rural cooperatives for this purpose.

#### ***Explanation of Provision***

The bill provides that a rural cooperative plan that includes a cash or deferred arrangement may permit distributions to plan participants after the attainment of age 59½ or on account of hardship. In addition, the definition of a rural cooperative is expanded to include certain public utility districts and a national association of rural cooperatives.

#### ***Effective Date***

The provision generally is effective for distributions after the date of enactment. The modifications to the definition of a rural cooperative apply to plan years beginning after December 31, 1996.

### **4. Treatment of governmental plans under section 415 (sec. 1444 of the bill and secs. 415 and 457 of the Code)**

#### ***Present Law***

Present law imposes limits on contributions and benefits under qualified plans based on the type of plan (sec. 415). Certain special rules apply to State and local governmental plans under which such plans may provide benefits greater than those permitted by the limits on benefits applicable to plans maintained by private employers.

In the case of defined benefit pension plans, the limit on the annual retirement benefit is the lesser of (1) 100 percent of compensation or (2) \$120,000 (indexed for inflation). The dollar limit is reduced in the case of early retirement or if the employee has less than 10 years of plan participation.

### ***Reasons for Change***

The limits on contributions and benefits create unique problems for plans maintained by public employers.

### ***Explanation of Provision***

The bill makes the following modifications to the limits on contributions and benefits as applied to governmental plans:

- (1) the 100 percent of compensation limitation on defined benefit pension plan benefits would not apply; and
- (2) the early retirement reduction and the 10-year phase-in of the defined benefit pension plan dollar limit would not apply to certain disability and survivor benefits.

The bill also permits State and local government employers to maintain excess benefit plans without regard to the limits on unfunded deferred compensation arrangements of State and local government employers (sec. 457).

### ***Effective Date***

The provision is effective for years beginning after December 31, 1994. No inference is intended with respect to whether a governmental plan complies with the requirements of section 415 with respect to years beginning before January 1, 1995. With respect to such years, the Secretary is directed to enforce the requirements of section 415 consistent with the provision.

## **5. Uniform retirement age (sec. 1445 of the bill and sec. 401(a)(5) of the Code)**

### ***Present Law***

A qualified plan generally must provide that payment of benefits under the plan must begin no later than 60 days after the end of the plan year in which the participant reaches age 65. Also, for purpose of the vesting and benefit accrual rules, normal retirement age generally can be no later than age 65. For purposes of applying the limits on contributions and benefits (sec. 415), Social Security retirement age is generally used as retirement age. The Social Security retirement age as used for such purposes is presently age 65, but is scheduled to gradually increase.

### ***Reasons for Change***

Many plans base benefits on social security retirement age so that the benefits under the plan complement social security. Under present law, plans that do so may fail applicable nondiscrimination tests. It is believed that the social security retirement age is an appropriate age for use under plans maintained by private employers.

### ***Explanation of Provision***

The bill provides that for purposes of the general nondiscrimination rules (sec. 401(a)(4)) the Social Security retirement age (as defined in sec. 415) is a uniform retirement age and that subsidized early retirement benefits and joint and survivor annuities are not treated as not being available to employees on the same terms

merely because they are based on an employee's Social Security retirement age (as defined in sec. 415).

***Effective Date***

The provision is effective for years beginning after December 31, 1996.

**6. Contributions on behalf of disabled employees (sec. 1446 of the bill and sec. 415(c)(3) of the Code)**

***Present Law***

Under present law, an employer may elect to continue deductible contributions to a defined contribution plan on behalf of an employee who is permanently and totally disabled. For purposes of the limit on annual additions (sec. 415(c)), the compensation of a disabled employee is deemed to be equal to the annualized compensation of the employee prior to the employee's becoming disabled. Contributions are not permitted on behalf of disabled employees who were officers, owners, or highly compensated before they became disabled.

***Reasons for Change***

It is appropriate to facilitate the provision of benefits for disabled employees, if it is done on a nondiscriminatory basis.

***Explanation of Provision***

The bill provides that the special rule for contributions on behalf of disabled employees is applicable without an employer election and to highly compensated employees if the defined contribution plan provides for the continuation of contributions on behalf of all participants who are permanently and totally disabled.

***Effective Date***

The provision is effective for years beginning after December 31, 1996.

**7. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations (sec. 1447 of the bill and sec. 457(e) of the Code)**

***Present Law***

Under a section 457 plan, an employee who elects to defer the receipt of current compensation is taxed on the amounts deferred when such amounts are paid or made available. The maximum annual deferral under such a plan is the lesser of (1) \$7,500 or (2) 33 $\frac{1}{3}$  percent of compensation (net of the deferral).

Amounts deferred under a section 457 plan may not be made available to an employee before the earliest of (1) the calendar year in which the participant attains age 70 $\frac{1}{2}$ , (2) when the participant is separated from the service with the employer, or (3) when the participant is faced with an unforeseeable emergency.

Benefits under a section 457 plan are not treated as made available if the participant may elect to receive a lump sum payable after separation from service and within 60 days of the election. This exception is available only if the total amount payable to the participant under the plan does not exceed \$3,500 and no additional amounts may be deferred under the plan with respect to the participant.

### ***Reasons for Change***

It is appropriate to index the dollar limits on deferrals under section 457 plans to maintain the value of the deferral and to provide two additional exceptions to the principle of constructive receipt with respect to distributions from such plans.

### ***Explanation of Provision***

The bill makes three changes to the rules governing section 457 plans.

The bill: (1) permits in-service distributions of accounts that do not exceed \$3,500 under certain circumstances; (2) increases the number of elections that can be made with respect to the time distributions must begin under the plan, and (3) provides for indexing (in \$500 increments) of the dollar limit on deferrals.

### ***Effective Date***

The provision is effective for taxable years beginning after December 31, 1996.

## **8. Trust requirement for deferred compensation plans of State and local governments (sec. 1448 of the bill and sec. 457 of the Code)**

### ***Present Law***

Until deferrals under a section 457 plan are made available to a plan participant, such amounts deferred, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights must remain solely the property and rights of the employer, subject only to the claims of the employer's general creditors.

### ***Reasons for Change***

The Committee is concerned about the potential for employees of certain State and local governments to lose significant portions of their retirement savings because their employer has chosen to provide benefits through an unfunded deferred compensation plan rather than a qualified pension plan. Therefore, the Committee finds it appropriate to require that benefits under a section 457 plan of a State and local government should be held in a trust (or custodial account or annuity contract) to insulate the retirement benefits of employees from the claims of the employer's creditors.

### ***Explanation of Provision***

Under the bill, all amounts deferred under a section 457 plan maintained by a State and local governmental employer have to be held in trust (or custodial account or annuity contract) for the exclusive benefit of employees. The trust (or custodial account or annuity contract) is provided tax-exempt status. Amounts will not be considered made available merely because they are held in a trust, custodial account, or annuity contract.

### ***Effective Date***

The provision generally is effective with respect to amounts held on or after the date of enactment. In the case of amounts deferred before the date of enactment, a trust will not need to be established by reason of this provision until January 1, 1999.

### **9. Correction of GATT interest and mortality rate provisions in the Retirement Protection Act (sec. 1449 of the bill and sec. 767 of the General Agreement on Tariffs and Trade)**

#### ***Present Law***

The Retirement Protection Act of 1994, enacted as part of the implementing legislation for the General Agreement on Tariffs and Trade ("GATT"), modified the actuarial assumptions that must be used in adjusting benefits and limitations. In general, in adjusting a benefit that is payable in a form other than a straight life annuity and in adjusting the dollar limitation if benefits begin before age 62, the interest rate to be used cannot be less than the greater of 5 percent or the rate specified in the plan. Under GATT, if the benefit is payable in a form subject to the requirements of section 417(e)(3), then the interest rate on 30-year Treasury securities is substituted for 5 percent. Also under GATT, for purposes of adjusting any limit or benefit, the mortality table prescribed by the Secretary must be used.

This provision of GATT is generally effective as of the first day of the first limitation year beginning in 1995.

GATT made similar changes to the interest rate and mortality assumptions used to calculate the value of lump-sum distributions for purposes of the rule permitting involuntary dispositions of certain accrued benefits. In the case of a plan adopted and in effect before December 8, 1995, those provisions do not apply before the earlier of (1) the date a plan amendment applying the new assumption is adopted or made effective (whichever is later), or (2) the first day of the first plan year beginning after December 31, 1999.

#### ***Reasons for Change***

The Committee is aware that the GATT provisions enacted in the 103rd Congress had the result of reducing the benefit payments to certain pension plan beneficiaries. The Committee believes that it is appropriate to ameliorate this result by providing the same transition period for the modifications to limits on contributions and benefits to that provided under similar GATT provisions, and by providing that the interest rate to be used to reduce the dollar limit



on benefits under section 415 in cases where the participant retires before age 62 should be the same regardless of the form of benefit.

### ***Explanation of Provision***

The bill conforms the effective date of the new interest rate and mortality assumptions that must be used under section 415 to calculate the limits on benefits and contributions to the effective date of the provision relating to the calculation of lump-sum distributions. This rule applies only in the case of plans that were adopted and in effect before the date of enactment of GATT (December 8, 1994). To the extent plans have already been amended to reflect the new assumptions, plan sponsors are permitted within 1 year of the date of enactment to amend the plan to reverse retroactively such amendment.<sup>11</sup>

The bill also repeals the GATT provision which requires that if the benefit is payable before age 62 in a form subject to the requirements of section 417(e)(3) (e.g., lump sum), then the interest rate to be used to reduce the dollar limit on benefits under section 415 cannot be less than the greater of the rate on 30-year Treasury securities or the rate specified in the plan. Consequently, regardless of the form of benefit, the interest rate to be used cannot be less than the greater of 5 percent or the rate specified in the plan.

### ***Effective Date***

The provision is effective as if included in GATT.

## **10. Multiple salary reduction agreements permitted under section 403(b) (sec. 1450(a) of the bill and sec. 403(b) of the Code)**

### ***Present Law***

Under Treasury regulations, a participant in a tax-sheltered annuity plan (sec. 403(b)) is not permitted to enter into more than one salary reduction agreement in any taxable year. These regulations further provide that a salary reduction agreement is effective only with respect to amounts “earned” after the agreement becomes effective, and that a salary reduction agreement must be irrevocable with respect to amounts earned while the agreement is in effect.

These restrictions do not apply to other elective deferral arrangements such as a qualified cash or deferred arrangement (sec. 401(k)). Under Treasury regulations, participants in a qualified cash or deferred arrangement may enter into more than one salary reduction agreement in a taxable year, such an agreement is effective

<sup>11</sup> The Committee intends that plan sponsors will have flexibility in adopting the actuarial assumptions required under GATT. For example, plan sponsors are permitted to apply the actuarial assumptions that must be used for 415 purposes retroactively as provided under GATT. Alternatively, plan sponsors can apply such actuarial assumptions prospectively by either (1) providing a benefit equal to (i) the accrued benefit as of the effective date of the adoption of the new actuarial assumptions determined after applying section 415 using the old actuarial assumptions, plus (ii) the benefit accrued after such effective date determined after applying section 415 using the new actuarial assumptions; or (2) providing a benefit equal to the greater of (i) the accrued benefit as the effective date of the adoption of the new actuarial assumptions determined after applying section 415 using the old actuarial assumptions, or (ii) the entire accrued benefit determined after applying section 415 using the new actuarial assumptions.

tive with respect to compensation currently available to the participant after the agreement becomes effective even though previously “earned,” and the agreement may be revoked by the participant.

### ***Reasons for Change***

It is appropriate to conform the treatment of salary reduction agreements under section 403(b) to the treatment of qualified cash or deferred arrangements.

### ***Explanation of Provision***

The bill provides that for participants in a tax-sheltered annuity plan, the frequency that a salary reduction agreement may be entered into, the compensation to which such agreement applies, and the ability to revoke such agreement shall be determined under the rules applicable to qualified cash or deferred arrangements.

### ***Effective Date***

The provision is effective for taxable years beginning after December 31, 1995.

## **11. Treatment of Indian tribal governments under section 403(b) (sec. 1450(b) of the bill and sec. 403(b) of the Code)**

### ***Present Law***

Under present law, certain tax-exempt employers and certain State and local government educational organizations are permitted to maintain tax-sheltered annuity plans (sec. 403(b)). Indian tribal governments are treated as States for this purpose, so certain educational organizations associated with a tribal government are eligible to maintain tax-sheltered annuity plans.

### ***Reasons for Change***

The Committee believes that there is some uncertainty under present law about the ability of Indian tribal governments to establish 403(b) plans for all tribal government employees. Following enactment of the Indian Tribal Government Tax Status Act of 1982, several insurance companies and financial advisors marketed 403(b) plans to tribes representing that the plans could be adopted on a tribal-wide basis to cover all employees. As a result, many tribes adopted 403(b) plans for their employees that are not in compliance with the law. Given this uncertainty, the Committee believes it is appropriate to requalify such plans.

### ***Explanation of Provision***

The bill provides that any 403(b) annuity contract purchased in a plan year beginning before January 1, 1995 by an Indian tribal government shall be treated as purchased by an entity permitted to maintain a tax-sheltered annuity plan. The bill also provides that such contracts may be rolled over into a section 401(k) plan maintained by the Indian tribal government.

*Effective Date*

The provision is effective on the date of enactment.

**12. Application of elective deferral limit to section 403(b) contracts (sec. 1450(c) of the bill and sec. 403(b) of the Code)**

*Present Law*

A tax-sheltered annuity plan must provide that elective deferrals made under the plan on behalf of an employee may not exceed the annual limit on elective deferrals (\$9,500 for 1996). Plans that do not comply with this requirement may lose their tax-favored status.

*Reasons for Change*

The Committee does not believe that employees participating in a tax-sheltered annuity plan should be negatively affected if other employees violate the annual limit on elective deferrals with respect to their individual tax-sheltered annuity contracts (or custodial accounts).

*Explanation of Provision*

Under the bill, each tax-sheltered annuity contract, not the tax-sheltered annuity plan, must provide that elective deferrals made under the contract may not exceed the annual limit on elective deferrals. The Committee intends that the contract terms be given effect in order for this requirement to be satisfied. Thus, for example, if the annuity contract issuer takes no steps to ensure that deferrals under the contract do not exceed the applicable limit, then the contract will not be treated as satisfying section 403(b). The provision is intended to make clear that the exclusion of elective deferrals from gross income by employees who have not exceeded the annual limit on elective deferrals will not be affected to the extent other employees exceed the annual limit. However, if the occurrence of an uncorrected elective deferral made by an employee is attributable to reasonable error, the contract will not fail to satisfy section 403(b), and only the portion of the elective deferral in excess of the annual limit would be includible in gross income.

*Effective Date*

The provision is effective for years beginning after December 31, 1995, except that an annuity contract is not required to meet any change in any requirement by reason of the provision before the 90th day after the date of enactment.

**13. Waiver of minimum waiting period for qualified plan distributions (sec. 1451 of the bill and sec. 417(c) of the Code)**

*Present Law*

Under present law, in the case of a qualified joint and survivor annuity, a written explanation of the form of benefit must generally be provided to participants no less than 30 days and no more

than 90 days before the annuity starting date. Even if a participant has elected to waive the qualified joint and survivor annuity and the spouse has consented to the distribution, the distribution from the plan cannot be made until 30 days after the written explanation was provided to the participant.<sup>12</sup>

### ***Reasons for Change***

The Committee believes that the notice period applicable to a QJSA should not prevent the payment of benefits if such period is waived by the plan participant and, if applicable, the participant's spouse.

### ***Explanation of Provision***

The bill provides that the minimum period between the date the explanation of the qualified joint and survivor annuity is provided and the annuity starting date does not apply if it is waived by the participant and, if applicable, the participant's spouse. For example, if the participant has not elected to waive the qualified joint and survivor annuity, only the participant needs to waive the minimum waiting period.

### ***Effective Date***

The provision is effective with respect to plan years beginning after December 31, 1996.

## **14. Repeal of combined plan limit (sec. 1452 of the bill and sec. 415(e) of the Code)**

### ***Present Law***

#### ***Combined plan limit***

Present law provides limits on contributions and benefits under qualified retirement plans based on the type of plan (i.e., based on whether the plan is a defined contribution plan or a defined benefit pension plan). An overall limit applies if an individual is a participant in both a defined benefit pension plan and a defined contribution plan (called the combined plan limit).

#### ***Excess distribution tax***

Present law imposes a 15-percent excise tax on excess distributions from qualified retirement plans, tax-sheltered annuities, and IRAs. Excess distributions are generally the aggregate amount of retirement distributions from such plans during any calendar year in excess of \$150,000 (or \$750,000 in the case of a lump-sum distribution). An additional 15-percent estate tax is also imposed on an individual's excess retirement accumulation.

<sup>12</sup> On September 15, 1995, Treasury issued temporary regulations (T.D. 8620) which provide that a plan may permit a participant to elect (with any applicable spousal consent) a distribution with an annuity starting date before 30 days have elapsed since the explanation was provided, as long as the distribution commences more than seven days after the explanation was provided. Consequently, even if the participant (and spouse, if applicable) has elected to waive the minimum waiting period for receiving a qualified plan distribution, the distribution from the plan cannot be made until seven days have elapsed since the explanation was provided to the participant.

### ***Reasons for Change***

One of the most significant sources of complexity relating to qualified pension plans is the calculation of the combined plan limit under section 415(e). Many new employers do not establish defined benefit pension plans, which provide employees with the greatest retirement income security. One of the reasons that defined benefit pension plans are not being established is because of the complex rules governing these plans and the significant administrative costs entailed in maintaining them. Section 415(e) is just one of the deterrents to the establishment and maintenance of qualified defined benefit pension plans. Thus, the Committee does not believe that the administrative costs associated with section 415(e) and the complexity of the calculations required are justified. Further, the Committee believes that section 415(e) may have the effect of discouraging employers from providing adequate retirement benefits to their employees.

The excise tax on excess distributions has a similar purpose to the combined plan limit, although it applies to all of an individual's retirement distributions, not just those from a single employer. The Committee believes that both the combined plan limit and the excise tax on excess distributions should not apply at the same time.

### ***Explanation of Provision***

#### ***Combined plan limit***

The bill repeals the combined plan limit.

#### ***Excess distribution tax***

Until the repeal of the combined plan limit is effective, the bill suspends the excise tax on excess distributions. The additional estate tax on excess accumulations continues to apply.

### ***Effective Date***

The provision repealing the combined plan limit is effective with respect to limitation years beginning after December 31, 1998. The provision relating to the excise tax on excess distributions is effective with respect to distributions received in 1996, 1997, and 1998.

## **15. Tax on prohibited transactions (sec. 1453 of the bill and sec. 4975 of the Code)**

### ***Present Law***

Present law prohibits certain transactions (prohibited transactions) between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries. A two-tier excise tax is imposed on prohibited transactions. The initial level tax is equal to 5 percent of the amount involved with respect to the transaction. If the transaction is not corrected within a certain period, a tax equal to 100 percent of the amount involved may be imposed.

### ***Reasons for Change***

The Committee believes it is appropriate to increase the initial level prohibited transaction tax to discourage disqualified persons from engaging in such transactions.

### ***Explanation of Provision***

The bill increases the initial-level prohibited transaction tax from 5 percent to 10 percent.

### ***Effective Date***

The provision is effective with respect to prohibited transactions occurring after the date of enactment.

## **16. Treatment of leased employees (sec. 1454 of the bill and sec. 414(n) of the Code)**

### ***Present Law***

An individual (a leased employee) who performs services for another person (the recipient) may be required to be treated as the recipient's employee for various employee benefit provisions, if the services are performed pursuant to an agreement between the recipient and any other person (the leasing organization) who is otherwise treated as the individual's employer (sec. 414(n)). The individual is to be treated as the recipient's employee only if the individual has performed services for the recipient on a substantially full-time basis for a year, and the services are of a type historically performed by employees in the recipient's business field.

An individual who otherwise would be treated as a recipient's leased employee will not be treated as such an employee if the individual participates in a safe harbor plan maintained by the leasing organization meeting certain requirements. Each leased employee is to be treated as an employee of the recipient, regardless of the existence of a safe harbor plan, if more than 20 percent of an employer's nonhighly compensated workforce are leased.

### ***Reasons for Change***

The leased employee rules are complex and have unexpected and sometimes indefensible results, especially as interpreted under regulations proposed by the Secretary. For example, under the "historically performed" standard, the employees and partners of a law firm may be the leased employees of a client of the firm if they work a sufficient number of hours for the client and if it is not unusual for employers in that business field to have in-house counsel. While arguably meeting the present-law leased employee definition, it is believed that situations such as this are outside the intended scope of the rules.

### ***Explanation of Provision***

Under the bill, the present-law "historically performed" test is replaced with a new test under which an individual is not considered a leased employee unless the individual's services are performed under primary direction or control by the service recipient. As

under present law, the determination of whether someone is a leased employee is made after determining whether the individual is a common-law employee of the recipient. Thus, an individual who is not a common-law employee of the service recipient could nevertheless be a leased employee of the service recipient. Similarly, the fact that a person is or is not found to perform services under primary direction or control of the recipient for purposes of the employee leasing rules is not determinative of whether the person is or is not a common-law employee of the recipient.

Whether services are performed by an individual under primary direction or control by the service recipient depends on the facts and circumstances. In general, primary direction and control means that the service recipient exercises the majority of direction and control over the individual. Factors that are relevant in determining whether primary direction or control exists include whether the individual is required to comply with instructions of the service recipient about when, where, and how he or she is to perform the services, whether the services must be performed by a particular person, whether the individual is subject to the supervision of the service recipient, and whether the individual must perform services in the order or sequence set by the service recipient. Factors that generally are not relevant in determining whether such direction or control exists include whether the service recipient has the right to hire or fire the individual and whether the individual works for others.

For example, an individual who works under the direct supervision of the service recipient would be considered to be subject to primary direction or control of the service recipient even if another company hired and trained the individual, had the ultimate (but unexercised) legal right to control the individual, paid his wages, withheld his employment and income taxes, and had the exclusive right to fire him. Thus, for example, temporary secretaries, receptionists, word processing personnel and similar office personnel who are subject to the day-to-day control of the employer in essentially the same manner as a common law employee are treated as leased employees if the period of service threshold is reached.

On the other hand, an individual who is a common-law employee of Company A who performs services for Company B on the business premises of Company B under the supervision of Company A would generally not be considered to be under primary direction or control of Company B. The supervision by Company A must be more than nominal, however, and not merely a mechanism to avoid the literal language of the direction or control test.

An example of the situation in the preceding paragraph might be a work crew that comes into a factory to install, repair, maintain, or modify equipment or machinery at the factory. The work crew includes a supervisor who is an employee of the equipment (or equipment repair) company and who has the authority to direct and control the crew, and who actually does exercise such direction and control. In this situation, the supervisor and his or her crew are required to comply with the safety and environmental precautions of the manufacturer, and the supervisor is in frequent communication with the employees of the manufacturer. As another example, certain professionals (e.g., attorneys, accountants,

actuaries, doctors, computer programmers, systems analysts, and engineers) who regularly make use of their own judgement and discretion on matters of importance in the performance of their services and are guided by professional, legal, or industry standards, are not leased employees even though the common law employer does not closely supervise the professional on a continuing basis, and the service recipient requires the services to be performed on site and according to certain stages, techniques, and timetables. In addition to the example above, outside professionals who maintain their own businesses (e.g., attorneys, accountants, actuaries, doctors, computer programmers, systems analysts, and engineers) generally would not be considered to be subject to such primary direction or control.

Under the direction or control test, clerical and similar support staff (e.g., secretaries and nurses in a doctor's office) generally would be considered to be subject to primary direction or control of the service recipient and would be leased employees provided the other requirements of section 414(n) are met.

In many cases, the "historically performed" test is overly broad, and results in the unintended treatment of individuals as leased employees. One of the principal purposes for changing the leased employee rules is to relieve the unnecessary hardship and uncertainty created for employers in these circumstances. However, it is not intended that the direction or control test enable employers to engage in abusive practices. Thus, it is intended that the Secretary interpret and apply the leased employee rules in a manner so as to prevent abuses. This ability to prevent abuses under the leasing rules is in addition to the present-law authority of the Secretary under section 414(o). For example, one potentially abusive situation exists where the benefit arrangements of the service recipient overwhelmingly favor its highly compensated employees, the employer has no or very few nonhighly compensated common-law employees, yet the employer makes substantial use of the services of nonhighly compensated individuals who are not its common-law employees.

### ***Effective Date***

The provision is effective for years beginning after December 31, 1996, except that the bill would not apply to relationships that have been previously determined by an IRS ruling not to involve leased employees. In applying the leased employee rules to years beginning before the effective date, it is intended that the Secretary use a reasonable interpretation of the statute to apply the leasing rules to prevent abuse.

## **17. Uniform penalty provisions to apply to certain pension reporting requirements (sec. 1455 of the bill and secs. 6652(i) and 6724(d) of the Code)**

### ***Present Law***

Any person who fails to file an information report with the IRS on or before the prescribed filing date is subject to penalties for each failure. A different, flat-amount penalty applies for each failure to provide information reports to the IRS or statements to payees relating to pension payments.



***Reasons for Change***

Conforming the information-reporting penalties that apply with respect to pension payments to the general information-reporting penalty structure would simplify the overall penalty structure through uniformity and provide more appropriate information-reporting penalties with respect to pension payments.

***Explanation of Provision***

The bill incorporates into the general penalty structure the penalties for failure to provide information reports relating to pension payments to the IRS and to recipients.

***Effective Date***

The provision is effective with respect to returns and statements the due date for which is after December 31, 1996.

**18. Retirement benefits of ministers not subject to tax on net earnings from self-employment (sec. 1456 of the bill and sec. 1402(a) of the Code)**

***Present Law***

Under present law, certain benefits provided to ministers after they retire are subject to self-employment tax.

***Reasons for Change***

The Committee believes that, like retirement benefits paid from qualified plans sponsored by private employers, retirement benefits paid from church plans to ministers should not be subject to self-employment tax. The Committee believes this treatment should also apply to the rental value of any parsonage (including utilities) provided after retirement.

***Explanation of Provision***

The bill provides that retirement benefits received from a church plan after a minister retires, and the rental value of a parsonage (including utilities) furnished to a minister after retirement, are not subject to self-employment taxes.

***Effective Date***

The provision is effective for years beginning before, on, or after December 31, 1994.

**19. Date for adoption of plan amendments (sec. 1457 of the bill)**

***Present Law***

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

### ***Reasons for Change***

Plan sponsors should have adequate time to amend plan documents.

### ***Explanation of Provision***

The bill generally provides that any amendments to a plan or annuity contract required by the pension simplification bills would not be required to be made before the first plan year beginning on or after January 1, 1997. The date for amendments is extended to the first plan year beginning on or after January 1, 1999, in the case of a governmental plan.

### ***Effective Date***

The provision is effective on the date of enactment.

## **E. Foreign Simplification Provision**

### **1. Repeal of excess passive assets provision (sec. 1501 of the bill and sec. 956A of the Code)**

#### ***Present Law***

Under the rules of subpart F (secs. 951–964), certain 10-percent U.S. shareholders of a controlled foreign corporation (CFC) are required to include in income currently for U.S. tax purposes certain earnings of the CFC, whether or not such earnings are actually distributed currently to the shareholders. The 10-percent U.S. shareholders of a CFC are subject to current U.S. tax on their shares of certain income earned by the CFC (referred to as “subpart F income”). The 10-percent U.S. shareholders are also subject to current U.S. tax on their shares of the CFC’s earnings to the extent such earnings are invested by the CFC in certain U.S. property.

In addition to these current inclusion rules, the Omnibus Budget Reconciliation Act of 1993 enacted section 956A, which applies another current inclusion rule to U.S. shareholders of a CFC. Section 956A requires the 10-percent U.S. shareholders of a CFC to include in income currently their shares of the CFC’s earnings to the extent such earnings are invested by the CFC in excess passive assets. A CFC generally is treated as having excess passive assets if the average of the amounts of its passive assets exceeds 25 percent of the average of the amounts of its total assets; this calculation requires a quarterly determination of the CFC’s passive assets and total assets.

### ***Reasons for Change***

With the enactment of section 956A, the 1993 Act added an additional layer of complexity to the subpart F rules. In addition to determining the current inclusions with respect to a CFC’s subpart F income and earnings invested in U.S. property, the U.S. shareholders must now also determine the current inclusion with respect to the CFC’s earnings invested in excess passive assets. Application of section 956A requires determination and measurement of the CFC’s passive assets and total assets on a quarterly basis. The

Committee understands that compliance with section 956A imposes substantial administrative burdens on both taxpayers and the IRS.

The Committee also understands that section 956A was enacted in order to restrict the benefits of tax deferral for CFCs that accumulate passive assets abroad. However, the Committee further understands that the rules of section 956A operate to provide incentives for CFCs to make investments, enter into transactions, and engage in reorganizations for the purpose of avoiding the application of such section. The Committee has been informed that CFCs acquire foreign assets that would not otherwise be attractive investments if such acquisitions reduce the CFC's percentage of passive assets below the threshold for application of section 956A. The Committee has been further informed that some U.S. shareholders of CFCs view section 956A as having the effect of an investment tax credit for foreign investments by CFCs. The Committee is concerned that section 956A provides taxpayers with incentives to engage in costly, non-economic transactions. The Committee is further concerned that section 956A provides incentives for taxpayers to make investments outside the United States that might otherwise be made in the United States. The Committee believes that the administrative burdens of compliance coupled with the costs associated with transactions undertaken to avoid its application call into question the appropriateness of section 956A.

#### ***Explanation of Provision***

The bill repeals section 956A.

#### ***Effective Date***

The provision applies to taxable years of foreign corporations beginning after December 31, 1996, and taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

## REVENUE OFFSETS

### **1. Phased-in repeal of Puerto Rico and possession tax credit (sec. 1601 of the bill and sec. 936 and new sec. 30A of the Code)**

#### ***Present Law***

Certain domestic corporations with business operations in the U.S. possessions (including, for this purpose, Puerto Rico and the U.S. Virgin Islands) may elect the Puerto Rico and possession tax credit which generally eliminates the U.S. tax on certain income related to their operations in the possessions. In contrast to the foreign tax credit, the possessions tax credit is a “tax sparing” credit. That is, the credit is granted whether or not the electing corporation pays income tax to the possession. Income exempt from U.S. tax under this provision falls into two broad categories: (1) possession business income, which is derived from the active conduct of a trade or business within a U.S. possession or from the sale or exchange of substantially all of the assets that were used in such a trade or business; and (2) qualified possession source investment income (“QPSII”), which is attributable to the investment in the possession or in certain Caribbean Basin countries of funds derived from the active conduct of a possession business.

In order to qualify for the Puerto Rico and possession tax credit for a taxable year, a domestic corporation must satisfy two conditions. First, the corporation must derive at least 80 percent of its gross income for the three-year period immediately preceding the close of the taxable year from sources within a possession. Second, the corporation must derive at least 75 percent of its gross income for that same period from the active conduct of a possession business.

A domestic corporation that has elected the Puerto Rico and possession tax credit and that satisfies these two conditions for a taxable year generally is entitled to a credit based on the U.S. income tax attributable to the sum of the taxpayer’s possession business income and its QPSII. However, the amount of the credit attributable to possession business income is subject to the limitations enacted by the Omnibus Budget Reconciliation Act of 1993 (“1993 Act”). Under the economic activity limit, the amount of the credit with respect to such income cannot exceed the sum of a portion of the taxpayer’s wage and fringe benefit expenses and depreciation allowances (plus, in certain cases, possession income taxes). In the alternative, the taxpayer may elect to apply a limit equal to the applicable percentage of the credit that would otherwise be allowable with respect to possession business income; the applicable percentage is phased down to 50 percent for 1996, 45 percent for 1997, and 40 percent for 1998 and thereafter. The amount of the Puerto Rico

and possession tax credit attributable to QPSII is not subject to these limitations.

### ***Reasons for Change***

The Committee understands that the tax benefits provided by the Puerto Rico and possession tax credit are enjoyed by only the relatively small number of U.S. corporations that operate in the possessions. Moreover, the Committee is concerned about the tax cost of the benefits provided to these possession corporations that is borne by all U.S. taxpayers. In light of current budget constraints, the Committee believes that the continuation of the tax exemption provided to corporations pursuant to the Puerto Rico and possession tax credit is no longer appropriate. However, the Committee believes that an appropriate transition period should be provided for corporations that have existing operations in the possessions. Moreover, the Committee believes that the credit computed under the economic activity limit for Puerto Rico should be moved to a new section of the Code contained in a subpart that includes other business-type credits; the credit computed under the economic activity limit operates as a credit in the traditional sense, measured by the level of employment and other economic activity engaged in by the taxpayer in the possession.

### ***Explanation of Provision***

The bill generally repeals the Puerto Rico and possession tax credit for taxable years beginning after December 31, 1995. However, the bill provides grandfather rules under which a corporation that is an existing credit claimant would be eligible to claim credits for a transition period. A special transition rule applies to the credit attributable to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

For taxable years beginning after December 31, 1995, the Puerto Rico and possession tax credit applies only to a corporation that qualifies as an existing credit claimant (as defined below). The determination of whether a corporation is an existing credit claimant is made separately for each possession. A corporation that is an existing credit claimant with respect to a possession is entitled to the credit for income from such possession for taxable years beginning after December 31, 1995, subject to the limitations described below. The credit, subject to such limitations, is computed separately for each possession with respect to which the corporation is an existing credit claimant.

The Puerto Rico and possession tax credit attributable to QPSII is eliminated for taxable years beginning after December 31, 1995. For taxable years beginning after December 31, 1995, the Puerto Rico and possession tax credit is available only with respect to possession business income. The computation of the Puerto Rico and possession tax credit attributable to possession business income during the grandfather period depends upon whether the corporation is using the economic activity limit or the applicable percentage limit.

For corporations that are existing credit claimants with respect to a possession and that use the economic activity limit, the posses-

sion tax credit attributable to business income from the possession (determined under the economic activity limit) continues to be determined as under present law for taxable years beginning after December 31, 1995 and before January 1, 2002. For taxable years beginning after December 31, 2001 and before January 1, 2006, the corporation's possession business income that is eligible for the credit is subject to a cap computed as described below. For taxable years beginning in 2006 and thereafter, the credit attributable to possession business income (determined under the economic activity limit) is eliminated.

The bill adds to the Code a new section which provides a credit determined under the economic activity limit for business income from Puerto Rico. Such credit is computed under the rules described above with respect to the possession tax credit determined under the economic activity limit. Such section applies for taxable years beginning after December 31, 1995 and before January 1, 2006.

For corporations that are existing credit claimants with respect to a possession and that elected to use the applicable percentage limit and not to use the economic activity limit, the Puerto Rico and possession tax credit attributable to business income from the possession continues to be determined as under present law for taxable years beginning after December 31, 1995 and before January 1, 1998. For taxable years beginning after December 31, 1997 and before January 1, 2006, the corporation's possession business income that is eligible for the credit is subject to a cap computed as described below. For taxable years beginning in 2006 and thereafter, the credit attributable to possession business income (determined under the applicable percentage limit) is eliminated.

A corporation that had elected to use the applicable percentage limit is permitted to revoke that election under present law. Under the bill, such a revocation is required to be made not later than with respect to the first taxable year beginning after December 31, 1996; such revocation, if made, applies to such taxable year and to all subsequent taxable years. Accordingly, a corporation that had an election in effect to use the applicable percentage limit could revoke such election effective for its taxable year beginning in 1997 and thereafter; such corporation would continue to use the applicable percentage limit for its taxable year beginning in 1996 and would use the economic activity limit for its taxable year beginning in 1997 and thereafter.

The cap on a corporation's possession business income that is eligible for the Puerto Rico and possession tax credit is computed based on the corporation's possession business income for the base period years ("average adjusted base period possession business income"). Average adjusted base period possession business income is the average of the adjusted possession business income for each of the corporation's base period years. For the purpose of this computation, the corporation's possession business income for a base period year is adjusted by an inflation factor that reflects inflation from such year to 1995. In addition, as a proxy for real growth in income throughout the base period, the inflation factor is increased by 5 percentage points compounded for each year from such year

to the corporation's first taxable year beginning on or after October 14, 1995.

The corporation's base period years generally are three of the corporation's five most recent years ending before October 14, 1995, determined by disregarding the taxable years in which the adjusted possession business incomes were highest and lowest. For purposes of this computation, only years in which the corporation had significant possession business income are taken into account. A corporation is considered to have significant possession business income for a taxable year if such income exceeds two percent of the corporation's possession business income for each of the six taxable years ending with the first taxable year ending on or after October 14, 1995. If the corporation has significant possession business income for only four of the five most recent taxable years ending before October 14, 1995, the base period years are determined by disregarding the year in which the corporation's possession business income was lowest. If the corporation has significant possession business income for three years or fewer of such five years, then the base period years are all such years. If there is no year of such five taxable years in which the corporation has significant possession business income, then the corporation is permitted to use as its base period its first taxable year ending on or after October 14, 1995; for this purpose, the amount of possession business income taken into account is the annualized amount of such income for the portion of the year ended September 30, 1995.

As one alternative, the corporation may elect to use its taxable year ending in 1992 as its base period (with the adjusted possession business income for such year constituting its cap). As another alternative, the corporation may elect to use as its cap the annualized amount of its possession business income for the first ten months of calendar year 1995, calculated by excluding any extraordinary items (as determined under generally accepted accounting principles) for such period. For this purpose, it is intended that transactions with a related party that are not in the ordinary course of business will be considered to be extraordinary items.

If a corporation's possession business income in a year for which the cap is applicable exceeds the cap, then the corporation's possession business income for purposes of computing its Puerto Rico and possession tax credit for the year is an amount equal to the cap. The corporation's credit continues to be subject to either the economic activity limit or the applicable percentage limit, with such limit applied to the corporation's possession business income as reduced to reflect the application of the cap.

A corporation is an existing credit claimant with respect to a possession if (1) the corporation is engaged in the active conduct of a trade or business within the possession on October 13, 1995, and (2) the corporation has elected the benefits of the Puerto Rico and possession tax credit pursuant to an election which is in effect for its taxable year that includes October 13, 1995. A corporation that adds a substantial new line of business after October 13, 1995, ceases to be an existing credit claimant as of the beginning of the taxable year during which such new line of business is added.

For purposes of these rules, a corporation is treated as engaged in the active conduct of a trade or business within a possession on

October 13, 1995, if such corporation is engaged in the active conduct of such trade or business before January 1, 1996, and such corporation has in effect on October 13, 1995, a binding contract for the acquisition of assets to be used in, or the sale of property to be produced in, such trade or business. For example, if a corporation has in effect on October 13, 1995, binding contracts for the lease of a facility and the purchase of machinery to be used in a manufacturing business in a possession and if the corporation begins actively conducting that manufacturing business in the possession before January 1, 1996, that corporation would be an existing credit claimant. A change in the ownership of a corporation will not affect its status as an existing credit claimant.

In determining whether a corporation has added a substantial new line of business, the Committee intends that principles similar to those reflected in Treas. Reg. section 1.7704-2(d) (relating to the transition rules for existing publicly traded partnerships) apply. For example, a corporation that modifies its current production methods, expands existing facilities, or adds new facilities to support the production of its current product lines and products within the same four-digit Industry Number Standard Industrial Classification Code (Industry SIC Code) will not be considered to have added a substantial new line of business. In this regard, the Committee intends that the fact that a business which is added is assigned a different four-digit Industry SIC Code than is assigned to an existing business of the corporation will not automatically cause the corporation to be considered to have added a new line of business. For example, a pharmaceutical corporation that begins manufacturing a new drug will not be considered to have added a new line of business. Moreover, a pharmaceutical corporation that begins to manufacture a complete product from the bulk active chemical through the finished dosage form, a process that may be assigned two separate four-digit Industry SIC Codes, will not be considered to have added a new line of business even though it was previously engaged in activities that involved only a portion of the entire manufacturing process from bulk chemicals to finished dosages. The Committee further intends that, in the case of a merger of affiliated possession corporations that are existing credit claimants, the corporation that survives the merger will not be considered to have added a substantial new line of business by reason of its operation of the existing business of the affiliate that was merged into it.

A special transition rule applies to the Puerto Rico and possession tax credit with respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands. For any taxable year beginning after December 31, 1995, and before January 1, 2006, a corporation that is an existing credit claimant with respect to one of these possessions for such year continues to determine its credit with respect to operations in such possession as under present law. For taxable years beginning in 2006 and thereafter, the Puerto Rico and possession tax credit with respect to operations in Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands is eliminated.



*Effective Date*

The provision is effective for taxable years beginning after December 31, 1995.

**2. Repeal 50-percent interest income exclusion for financial institution loans to ESOPs (sec. 1602 of the bill and sec. 133 of the Code)**

*Present Law*

A bank, insurance company, regulated investment company, or a corporation actively engaged in the business of lending money may generally exclude from gross income 50 percent of interest received on an ESOP loan (sec. 133). The 50-percent interest exclusion only applies if: (1) immediately after the acquisition of securities with the loan proceeds, the ESOP owns more than 50 percent of the outstanding stock or more than 50 percent of the total value of all outstanding stock of the corporation; (2) the ESOP loan term will not exceed 15 years; and (3) the ESOP provides for full pass-through voting to participants on all allocated shares acquired or transferred in connection with the loan.

*Reasons for Change*

The Committee believes that the 50-percent exclusion for interest with respect to ESOP loans provides an unnecessary tax benefit to financial institutions for loans they would make without regard to the interest exclusion. The Committee finds no evidence that employers that maintain ESOPs have less access to borrowing than other borrowers or that there is a need to provide an incentive to lenders to make money available to ESOPs.

*Explanation of Provision*

The bill repeals the 50-percent interest exclusion with respect to ESOP loans.

*Effective Date*

The provision is effective with respect to loans made after October 13, 1995, other than loans made pursuant to a written binding contract in effect on October 13, 1995, and at all times thereafter before such loan is made. The repeal of the 50-percent interest exclusion does not apply to the refinancing of an ESOP loan originally made on or before October 13, 1995, or pursuant to a binding contract in effect on such date, provided: (1) such refinancing loan otherwise meets the requirements of section 133 in effect on or before October 13, 1995; (2) the outstanding principal amount of the loan is not increased; and (3) the term of the refinancing loan does not extend beyond the term of the original ESOP loan.

**3. Apply look-through rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income (sec. 1603 of the bill and sec. 512 of the Code)**

***Present Law***

An organization that is exempt from tax by reason of Code section 501(a) (e.g., a charity, business league, or qualified pension trust) is nonetheless subject to tax on its unrelated business taxable income (UBTI) (sec. 511). Unrelated business taxable income generally excludes dividend income (sec. 512(b)(1)).

Special rules apply to a tax-exempt organization described in section 501(c)(3) or (c)(4) (i.e., a charity or social welfare organization) that is engaged in commercial-type insurance activities. Such activities are treated as an unrelated trade or business and the tax-exempt organization is subject to tax on the income from such insurance activities (including investment income that might otherwise be excluded from the definition of unrelated business taxable income) under subchapter L (sec. 501(m)(2)).<sup>13</sup> Accordingly, a tax-exempt organization described in section 501(c)(3) or (c)(4) generally is subject to tax on its income from commercial-type insurance activities in the same manner as a taxable insurance company.

A tax-exempt organization that conducts insurance activities through a foreign corporation is not subject to U.S. tax with respect to such activities. Under the subpart F rules, the United States shareholders (as defined in sec. 951(b)) of a controlled foreign corporation (“CFC”) are required to include in income currently their shares of certain income of the CFC, whether or not such income is actually distributed to the shareholders. This current inclusion rule applies to certain insurance income of the CFC (sec. 953). However, income inclusions under subpart F have been characterized as dividends for unrelated business income tax purposes.<sup>14</sup> Accordingly, insurance income earned by the CFC that is includible in income currently under subpart F by the taxable United States shareholders of the CFC is excluded from unrelated business taxable income in the case of a shareholder that is a tax-exempt organization.

<sup>13</sup> If the commercial-type insurance activities constitute a substantial part of the organization’s activities, the organization will not be tax-exempt under section 501(c)(3) or (c)(4) (sec. 501(m)(1)).

<sup>14</sup> The Internal Revenue Service has concluded in private letter rulings, which are not to be used or cited as precedent, that subpart F inclusions are treated as dividends received by the United States shareholder (a tax-exempt entity) for purposes of computing the shareholder’s UBTI (see LTRs 9407007 (November 12, 1993), 9027051 (April 13, 1990), 9024086 (March 22, 1990), 9024026 (March 15, 1990), 8922047 (March 6, 1989), 8836037 (June 14, 1988), 8819034 (February 10, 1988)). However, the IRS issued one private ruling in which it concluded that subpart F inclusions are treated as if the underlying income were realized directly by the United States shareholder (a tax-exempt entity) for purposes of computing the shareholder’s UBTI (see LTR 9043039 (July 30, 1990)). This ruling gave no explanation for the IRS’s departure from the position in its prior rulings, and the IRS reiterated in a subsequent ruling the position that subpart F inclusions are characterized as dividends for purposes of computing UBTI. Moreover, the application of the look-through rule in the ruling in question did not affect the ultimate result in the ruling because the income to which the subpart F inclusion was attributable was of a type that was excludible from UBTI. The Committee believes that LTR 9043039 (July 30, 1990) is incorrect in its application of a look-through rule in characterizing income inclusions under subpart F for unrelated business income tax purposes.

### ***Reasons for Change***

The unrelated business income tax rules are designed to prevent unfair competition by business operations that would otherwise be tax-favored due to their ownership by tax-exempt organizations. The rules applicable to certain tax-exempt organizations that conduct insurance activities directly are designed to ensure that such operations are taxed in the same manner as they would be taxed if conducted by a taxable entity. However, current law does not prevent unfair competition where operations involving the insurance of third-party risks are not conducted directly by such a tax-exempt organization itself, but are conducted by the organization through a controlled foreign corporation that is subject to little tax relative to competing U.S. businesses.

### ***Explanation of Provision***

The bill applies a look-through rule in characterizing certain subpart F insurance income for unrelated business income tax purposes. Under the bill, the look-through rule applies to amounts that constitute insurance income currently includible in gross income under the subpart F rules and that are not attributable to the insurance of risks of (1) the tax-exempt organization itself, (2) certain tax-exempt affiliates of such organization, or (3) an officer or director of, or an individual who (directly or indirectly) performs services for, the tax-exempt organization (or certain tax-exempt affiliates) provided that the insurance covers primarily risks associated with the individual's performance of services in connection with the tax-exempt organization (or tax-exempt affiliates). An individual who performs services for a tax-exempt organization through a partnership, for example, is indirectly performing services for such organization. The Committee intends that the determination of whether insurance covers primarily risks associated with the performance of services in connection with the tax-exempt organization or its tax-exempt affiliates will be based on all the facts and circumstances. The Committee further intends that a safe harbor be provided under which this "primarily" requirement will be considered to be satisfied where at least 80 percent of the services covered by the insurance are performed by the insured individual in connection with the tax-exempt organization or its tax-exempt affiliates. For purposes of determining whether the insurance covers risks associated with the individual's performance of services in connection with the tax-exempt organization, the Committee intends that the individual will not be considered to have performed services in connection with a tax-exempt organization solely by reason of the fact that the individual performs services at a facility leased to the individual by the tax-exempt organization.

For purposes of this bill, a tax-exempt organization is an affiliate of another tax-exempt organization if (1) the two organizations have significant common purposes and substantial common membership or (2) the two organizations have directly or indirectly substantial common direction or control.

The specified exceptions from the look-through rule apply on a shareholder by shareholder basis. Accordingly, if the subpart F insurance income allocable to a tax-exempt organization includes

both income attributable to the insurance of risks of the organization itself and income attributable to the insurance of risks of another shareholder that is not a tax-exempt affiliate of such organization, the look-through rule applies only to that portion of the income that represents income attributable to the insurance of risks of such other shareholder (and does not apply to the portion of the income that represents income attributable to the insurance of risks of the organization itself). In this regard, the Committee intends that if the CFC serves as a vehicle for the separate funding by each shareholder of its risks or liabilities for claims, without any pooling of a shareholder's risks or liabilities for claims with those of another shareholder either directly or through reinsurance, allocations that fairly reflect such arrangement will be respected for purposes of applying the look-through rule.

#### ***Effective Date***

The provision applies to amounts includible in gross income in taxable years beginning after December 31, 1995.

#### **4. Depreciation under the income forecast method (sec. 1604 of the bill and sec. 167 of the Code)**

##### ***Present Law***

##### ***In general***

A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through allowances for depreciation or amortization. Depreciation allowances for tangible property generally are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168, which provides that depreciation is computed by applying specific recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Intangible property generally is amortized under section 197, which provides a 15-year recovery period and the straight-line method to the cost of applicable property.

##### ***Treatment of film, video tape, and similar property***

MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording or to other any property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a unit-of-production method or other method of depreciation not expressed in a term of years. Section 197 does not apply to certain intangible property, including property produced by the taxpayer or any interest in a film, sound recording, video tape, book or similar property not acquired in transaction (or a series of related transactions) involving the acquisition of assets constituting a trade or business or substantial portion thereof. Thus, the recovery of the cost of a film, video tape, or similar property that is produced by the taxpayer or is acquired on a "stand-alone" basis by the taxpayer may not be determined under either the MACRS depreciation provisions or under the section 197 amortization provisions. The cost of such property may be determined under section 167, which allows a depreciation deduction for the

reasonable allowance for the exhaustion, wear and tear, or obsolescence of the property.

The “income forecast” method is an allowable method for calculating depreciation under section 167 for certain property. Under the income forecast method, the depreciation deduction for a taxable year for a property is determined by multiplying the cost of the property<sup>15</sup> (less estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life. The income forecast method has been held to be applicable for computing depreciation deductions for motion picture films, television films and taped shows, books, patents, master sound recordings and video games.<sup>16</sup> The total forecasted or estimated income to be derived from a property is to be based on the conditions known to exist at the end of the period for which depreciation is claimed. This estimate can be revised upward or downward at the end of a subsequent taxable period based on additional information that becomes available after the last prior estimate. These revisions, however, do not affect the amount of depreciation claimed in a prior taxable year.

In the case of a film, income to be taken into account under the income forecast method means income from the film less the expense of distributing the film, including estimated income from foreign distribution or other exploitation of the film.<sup>17</sup> In the case of a motion picture released for theatrical exhibition, income does not include estimated income from future television exhibition of the film (unless an arrangement for domestic television exhibition has been entered into before the film has been depreciated to its reasonable salvage value). In the case of a series or a motion picture produced for television exhibition, income does not include estimated income from domestic syndication of the series or the film (unless an arrangement for syndication has been entered into before the series or film has been depreciated to its reasonable salvage value).<sup>18</sup> The Internal Revenue Service also has ruled that income does not include net merchandising revenue received from the exploitation of film characters.<sup>19</sup>

<sup>15</sup> In *Transamerica Corp. v. U.S.*, 999 F.2d 1362, (9th Cir. 1993), the Ninth Circuit overturned the District Court and held that, for purposes of applying the income forecast method to a film, “cost of a film” includes “participation” and “residual” payments (i.e., payments to producers, writers, directors, actors, guilds, and others based on a percentage of the profits from the film) even though these payments were contingent on the occurrence of future events. It is unclear to what extent, if any, the *Transamerica* decision applies to amounts incurred after the enactment of the economic performance rules of Code section 461(h), as contained in the Deficit Reduction Act of 1984.

<sup>16</sup> See, e.g., Rev. Rul. 60-358, 1960-2 C.B. 68; Rev. Rul. 64-273, 1964-2 C.B. 62; Rev. Rul. 79-285, 1979-2 C.B. 91; and Rev. Rul. 89-62, 1989-1 C.B. 78. Conversely, the courts have held that certain tangible personal property was not of a character to which the income forecast method was applicable. See, e.g., *ABC Rentals of San Antonio v. Comm.*, 68 TCM 1362 (1994) (consumer durable property subject to short-term, “rent-to-own” leases not eligible) and *Carland, Inc. v. Comm.*, 90 T.C. 505 (1988), aff’d. on this issue, 909 F.2d 1101 (8th Cir. 1990) (railroad rolling stock subject to a lease not eligible).

<sup>17</sup> Rev. Rul. 60-358, 1960-2 C.B. 68.

<sup>18</sup> Rev. Proc. 71-29, 1971-2 C.B. 568.

<sup>19</sup> Private letter ruling 7918012, January 24, 1979. Private letter rulings do not have precedential authority and may not be relied upon by any taxpayer other than the taxpayer receiving the ruling but are some indication of IRS administrative practice.

### ***Reasons for Change***

The Committee believes that, in theory, the income forecast method is an appropriate method for matching the capitalized cost of certain property with the income produced by such property. However, the Committee believes that the application of the income forecast method under present law does not meet the theoretical objective of the method. In addition, the Committee recognizes that the reliance of the operation of the income forecast method upon estimated income may result in a mismatch between income and depreciation deductions when future income is over- or under-estimated. The Committee bill attempts to address these issues.

### ***Explanation of Provision***

The bill makes several amendments to the income forecast method of determining depreciation deductions.

#### ***Determination of estimated income***

First, the bill provides that income to be taken into account under the income forecast method includes all estimated income generated by the property. In applying this rule, a taxpayer generally need not take into account income expected to be generated after the close of the tenth taxable year after the year the property was placed in service. In the case of a film, television show, or similar property, such income includes, but is not necessarily limited to, income from foreign and domestic theatrical, television, and other releases and syndications; and video tape releases, sales, rentals, and syndications.

Pursuant to a special rule, in the case of television and motion picture films, the income from the property shall include income from the financial exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent the income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related to the taxpayer (within the meaning of sec. 267(b)). As an example of this special rule, assume a taxpayer produces a motion picture the subject of which is the adventures of a newly-created fictional character. If the taxpayer produces dolls or T-shirts using the character's image, income from the sales of these products by the taxpayer to consumers would be taken into account in determining depreciation for the motion picture under the income forecast method. Similarly, if the taxpayer enters into any licensing or similar agreement with an unrelated party with respect to the use of the image, such licensing income would be taken into account in determining depreciation for the motion picture. However, if the taxpayer uses the character's image to promote a ride at an amusement park that is wholly-owned by the taxpayer, no portion of the admission fees for the amusement park are to be taken into account under the income forecast method with respect to the motion picture.

In addition, pursuant to another special rule, if a taxpayer produces a television series and initially does not anticipate syndicating the episodes from the series, the forecasted income for the episodes of the first three years of the series need not take into ac-

count any future syndication fees (unless the taxpayer enters into an arrangement to syndicate such episodes during such period).

The 10th-taxable-year rule, the financial exploitation rule, and the syndication rule apply for purposes of the look-back method described below.

### ***Determination of income forecast property costs***

The cost of property subject to depreciation only includes amounts that satisfy the economic performance standard of section 461(h).<sup>20</sup> For this purpose, if the taxpayer incurs a noncontingent liability to acquire property subject to the income forecast method from another person, economic performance will be deemed to occur with respect to such noncontingent liability when the property is provided to the taxpayer. In addition, it is expected that the recurring item exception of section 461(h)(3) will apply in appropriate cases. Any costs that are taken into account after the property is placed in service are treated as a separate piece of property to the extent (1) such amounts are significant and are expected to give rise to a significant increase in the income from the property that was not included in the estimated income from the property, or (2) such costs are incurred more than 10 years after the property was placed in service. To the extent costs are incurred more than 10 years after the property was placed in service and give rise to a separate piece of property for which no income is generated, such costs may be written off and deducted they are incurred. For example, assume a taxpayer places property subject to the income forecast method in service during a taxable year and all income from the property is generated in the following four-year period. If the taxpayer incurs additional costs with respect to that property more than 10 years later (e.g., a payment pursuant to a deferred contingent compensation arrangement to a person that produced the property), such costs may be deducted in the year incurred provided no more income is generated with respect to such costs or the original property.

Any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year.

### ***Look-back method***

Finally, taxpayers that claim depreciation deductions under the income forecast method are required to pay (or would receive) interest based on the recalculation of depreciation under a “look-back” method.<sup>21</sup> The “look-back” method is applied in any “recomputation year” by (1) comparing depreciation deductions that had been claimed in prior periods to depreciation deductions that would have been claimed had the taxpayer used actual, rather than estimated, total income from the property; (2) determining the hypothetical overpayment or underpayment of tax based on this recalculated depreciation; and (3) applying the overpayment rate of section 6621 of the Code.

<sup>20</sup> No inference is intended as to the proper application of section 461(h) to the income forecast method under present law.

<sup>21</sup> The “look-back” method of the provision resembles the look-back method applicable to long-term contracts accounted for under the percentage-of-completion method of present-law sec. 460.

Except as provided in Treasury regulations, a “recomputation year” is the third and tenth taxable year after the taxable year the property was placed in service, unless the actual income from the property for each taxable year ending with or before the close of such years was within 10 percent of the estimated income from the property for such years. The Secretary of the Treasury has the authority to allow a taxpayer to delay the initial application of the look-back method where the taxpayer may be expected to have significant income from the property after the third taxable year after the taxable year the property was placed in service (e.g., the Treasury Secretary may exercise such authority where the depreciable life of the property is expected to be longer than three years).

In applying the look-back method, any cost that is taken into account after the property was placed in service may be taken into account by discounting (using the Federal mid-term rate determined under sec. 1274(d) as of the time the costs were taken into account) such cost to its value as of the date the property was placed in service. Property with an adjusted basis of \$100,000 or less when the property was placed in service is not subject to the look-back method. The provision provides a simplified look-back method for pass-through entities.

### *Effective Date*

The provision is effective for property placed in service after September 13, 1995, unless placed in service pursuant to a binding written contract in effect before such date and all times thereafter.

## **5. Modify exclusion of damages received on account of personal injury or sickness (sec. 1605 of the bill and sec. 104(a)(2) of the Code)**

### *Present Law*

Under present law, gross income does not include any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injury or sickness (sec. 104(a)(2)).

The exclusion from gross income of damages received on account of personal injury or sickness specifically does not apply to punitive damages received in connection with a case not involving physical injury or sickness. Courts presently differ as to whether the exclusion applies to punitive damages received in connection with a case involving a physical injury or physical sickness.<sup>22</sup> Certain States provide that, in the case of claims under a wrongful death statute, only punitive damages may be awarded.

Courts have interpreted the exclusion from gross income of damages received on account of personal injury or sickness broadly in some cases to cover awards for personal injury that do not relate to a physical injury or sickness. For example, some courts have

<sup>22</sup> The Supreme Court recently agreed to decide whether punitive damages awarded in a physical injury lawsuit are excludable from gross income. *Ogilvie v. U.S.*, 66 F.3d 1550 (10th Cir. 1995), cert. granted, 64 U.S.L.W. 3639 (U.S. March 25, 1996)(No. 95-966). Also, the Tax Court recently held that if punitive damages are not of a compensatory nature, they are not excludable from income, regardless of whether the underlying claim involved a physical injury or physical sickness. *Bagley v. Commissioner*, 105 T.C. No. 27 (1995).



held that the exclusion applies to damages in cases involving certain forms of employment discrimination and injury to reputation where there is no physical injury or sickness. The damages received in these cases generally consist of back pay and other awards intended to compensate the claimant for lost wages or lost profits. The Supreme Court recently held that damages received based on a claim under the Age Discrimination in Employment Act could not be excluded from income.<sup>23</sup> In light of the Supreme Court decision, the Internal Revenue Service has suspended existing guidance on the tax treatment of damages received on account of other forms of employment discrimination.

### ***Reasons for Change***

Punitive damages are intended to punish the wrongdoer and do not compensate the claimant for lost wages or pain and suffering. Thus, they are a windfall to the taxpayer and appropriately should be included in taxable income. Further, including all punitive damages in taxable income provides a bright-line standard which avoids prospective litigation on the tax treatment of punitive damages received in connection with a case involving a physical injury or physical sickness.

Damages received on a claim not involving a physical injury or physical sickness are generally to compensate the claimant for lost profits or lost wages that would otherwise be included in taxable income. The confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation, including two Supreme Court cases within the last four years. The taxation of damages received in cases not involving a physical injury or physical sickness should not depend on the type of claim made.

### ***Explanation of Provisions***

#### ***Include in income all punitive damages***

The bill provides that the exclusion from gross income does not apply to any punitive damages received on account of personal injury or sickness whether or not related to a physical injury or physical sickness. Under the bill, present law continues to apply to punitive damages received in a wrongful death action if the applicable State law (as in effect on September 13, 1995 without regard to subsequent modification) provides, or has been construed to provide by a court decision issued on or before such date, that only punitive damages may be awarded in a wrongful death action. The Committee intends no inference as to the application of the exclusion to punitive damages prior to the effective date of the bill in connection with a case involving a physical injury or physical sickness.

#### ***Include in income damage recoveries for nonphysical injuries***

The bill provides that the exclusion from gross income only applies to damages received on account of a personal physical injury or physical sickness. If an action has its origin in a physical injury

<sup>23</sup> *Schleier v. Commissioner*, 115 S. Ct. 2159 (1995).

or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse are excludable from gross income. In addition, damages (other than punitive damages) received on account of a claim of wrongful death continue to be excludable from taxable income as under present law.

The bill also specifically provides that emotional distress is not considered a physical injury or physical sickness.<sup>24</sup> Thus, the exclusion from gross income does not apply to any damages received (other than for medical expenses as discussed below) based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness. In addition, the exclusion from gross income specifically applies to the amount of damages received that is not in excess of the amount paid for medical care attributable to emotional distress.

The Committee intends no inference as to the application of the exclusion to damages prior to the effective date of the bill in connection with a case not involving a physical injury or physical sickness.

### *Effective Date*

The provisions generally are effective with respect to amounts received after June 30, 1996. The provisions do not apply to amounts received under a written binding agreement, court decree, or mediation award in effect on (or issued on or before) September 13, 1995.

## **6. Repeal advance refunds of diesel fuel tax for purchasers of diesel-powered automobiles, vans, and light trucks (sec. 1606 of the bill and sec. 6427(g) of the Code)**

### *Present Law*

Excise taxes are imposed on gasoline (14 cents per gallon) and diesel fuel (20 cents per gallon) to fund the Federal Highway Trust Fund. Before 1985, the gasoline and diesel fuel tax rates were the same. The predominate highway use of diesel fuel is by trucks. In 1984, the diesel excise tax rate was increased above the gasoline tax as the revenue offset for a reduction in the annual heavy truck use tax. Because automobiles, vans, and light trucks, did not benefit from the use tax reductions, a provision was enacted allowing first purchasers of model year 1979 and later diesel-powered automobiles and light trucks a tax credit to offset this increased diesel

<sup>24</sup> The Committee intends that the term emotional distress includes physical symptoms (e.g., insomnia, headaches, stomach disorders) which may result from such emotional distress.

fuel tax. The credit is \$102 for automobiles, and \$198 for vans and light trucks.

***Reasons for Change***

Changed driving patterns, and vehicles currently being marketed, have resulted in fewer diesel-powered automobiles, vans, and light trucks today than was the case when this advance refund was enacted. Additionally, the highway cost allocation study on which the refund was based is now outdated. The Committee believes, therefore, that this present-law tax credit is obsolete and should be repealed.

***Explanation of Provision***

The tax credit for purchasers of diesel-powered automobiles and light trucks is repealed.

***Effective Date***

This provision is effective for vehicles purchased after the date of the bill's enactment.

## **TAX TECHNICAL CORRECTIONS PROVISIONS**

The technical corrections subtitle contains clerical, conforming and clarifying amendments to the provisions enacted by the Revenue Reconciliation Act of 1990, the Revenue Reconciliation Act of 1993, and other recently enacted legislation. All amendments made by this title are meant to carry out the intent of Congress in enacting the original legislation. Therefore, no separate “Reasons for Change” is set forth for each individual amendment. Except as otherwise described, the amendments made by the technical corrections title take effect as if included in the original legislation to which each amendment relates.

### **A. Technical Corrections to the Revenue Reconciliation Act of 1990**

#### **1. Excise tax provisions**

- a. Application of the 2.5-cents-per-gallon tax on fuel used in rail transportation to States and local governments (sec. 1702(b)(2) of the bill, sec. 11211(b)(4) of the 1990 Act, and sec. 4093 of the Code)**

#### ***Present Law***

The 1990 Act increased the highway and motorboat fuels taxes by 5 cents per gallon, effective on December 1, 1990. The 1990 Act continued the exemption from these taxes for fuels used by States and local governments.

The 1990 Act further imposed a 2.5-cents-per-gallon tax on fuel used in rail transportation, also effective on December 1, 1990. Because of a drafting error, the 2.5-cents-per-gallon tax on fuel used in rail transportation incorrectly applies to fuel used by States and local governments.

#### ***Explanation of Provision***

The bill clarifies that the 2.5-cents-per-gallon tax on fuel used in rail transportation does not apply to such uses by States and local governments.

- b. Small winery production credit and bonding requirements (secs. 1702(b)(5), (6), and (7) of the bill, sec. 11201 of the 1990 Act, and sec. 5041 of the Code)**

#### ***Present Law***

A 90-cents-per-gallon credit is allowed to wine producers who produce no more than 250,000 gallons of wine in a year. The credit may be claimed against the producers’ excise or income taxes.

Wine producers must post a bond in amounts determined by reference to expected excise tax liability as a condition of legally operating.

***Explanation of Provision***

The bill clarifies that wine produced by eligible small wineries may be transferred without payment of tax to bonded warehouses that become liable for payment of the wine excise tax without losing credit eligibility. In such cases, the bonded warehouse will be eligible for the credit to the same extent as the producer otherwise would have been.

The bill further clarifies that the Treasury Department has broad regulatory authority to prevent the benefit of the credit from accruing (directly or indirectly) to wineries producing in excess of 250,000 gallons in a calendar year.

It is intended that the Treasury regulatory authority will extend to all circumstances in which wine production is increased with a purpose of securing indirect credit eligibility for wine produced by such large producers.

The bill also clarifies that the Treasury Department may take the amount of credit expected to be claimed against a producer's wine excise tax liability into account in determining the amount of required bond.

**2. Other revenue-increase provisions of the 1990 Act**

**a. Deposits of Railroad Retirement Tax Act taxes (sec. 1702(c)(3) of the bill, sec. 11334 of the 1990 Act, and sec. 6302(g) of the Code)**

***Present Law***

Employers must deposit income taxes withheld from employees' wages and FICA taxes that are equal to or greater than \$100,000 by the close of the next banking day. Under the Railroad Retirement Solvency Act of 1983, the deposit rules for withheld income taxes and FICA taxes automatically apply to Railroad Retirement Tax Act taxes (sec. 226 of P.L. 98-76).

***Explanation of Provision***

The bill conforms the Internal Revenue Code to the Railroad Retirement Solvency Act of 1983 by stating in the Code that these deposit rules for withheld income taxes and FICA taxes apply to Railroad Retirement Tax Act taxes.

**b. Treatment of salvage and subrogation of property and casualty insurance companies (sec. 1702(c)(4) of the bill and sec. 11305 of the 1990 Act)**

***Present Law***

For taxable years beginning after December 31, 1989, property and casualty insurance companies are required to reduce the deduction allowed for losses incurred (both paid and unpaid) by estimated recoveries of salvage and subrogation attributable to such losses. In the case of any property and casualty insurance company

that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, 87 percent of the discounted amount of the estimated salvage and subrogation recoverable as of the close of the last taxable year beginning before January 1, 1990, is allowed as a deduction ratably over the first 4 taxable years beginning after December 31, 1989. This special deduction was enacted in order to provide such property and casualty insurance companies with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the Revenue Reconciliation Act of 1990 did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

### ***Explanation of Provision***

The bill provides that the earnings and profits of any property and casualty insurance company that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, is to be determined without regard to the special deduction that is allowed over the first 4 taxable years beginning after December 31, 1989. The special deduction is to be taken into account, however, in determining earnings and profits for purposes of applying sections 56, 902, and subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986. This provision is considered necessary in order to provide those property and casualty insurance companies that took into account estimated salvage and subrogation recoverable in determining losses incurred with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the 1990 Act did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

### **c. Information with respect to certain foreign-owned or foreign corporations: Suspension of the statute of limitations during certain judicial proceedings (sec. 1702(c)(5) of the bill, secs. 11314 and 11315 of the 1990 Act, and secs. 6038A and 6038C of the Code)**

#### ***Present Law***

Any domestic corporation that is 25-percent owned by one foreign person is subject to certain information reporting and record-keeping requirements with respect to transactions carried out directly or indirectly with certain foreign persons treated as related to the domestic corporation ("reportable transactions") (sec. 6038A(a)). In addition, the Code provides procedures whereby an IRS examination request or summons with respect to reportable transactions can be served on foreign related persons through the domestic corporation (sec. 6038A(e)). Similar provisions apply to any foreign corporation engaged in a trade or business within the United States, with respect to information, records, examination requests, and summonses pertaining to the computation of its liability for tax in the United States (sec. 6038C). Certain noncompli-

ance rules may be applied by the Internal Revenue Service in the case of the failure by a domestic corporation to comply with a summons pertaining to a reportable transaction (a “6038A summons”) (sec. 6038A(e)), or the failure by a foreign corporation engaged in a U.S. trade or business to comply with a summons issued for purposes of determining the foreign corporation’s liability for tax in the United States (a “6038C summons”) (sec. 6038C(d)).

Any corporation that is subject to the provisions of section 6038A or 6038C has the right to petition a Federal district court to quash a 6038A or 6038C summons, or to review a determination by the IRS that the corporation did not substantially comply in a timely manner with the 6038A or 6038C summons (sec. 6038A(e)(4)(A) and (B); sec. 6038C(d)(4)). During the period that either such judicial proceeding is pending (including appeals), and for up to 90 days thereafter, the statute of limitations is suspended with respect to any transaction (or item, in the case of a foreign corporation) to which the summons relates (secs. 6038A(e)(4)(D), 6038C(d)(4)).

The legislative history of the 1989 Act amendments to section 6038A states that the suspension of the statute of limitations applies to “the taxable year(s) at issue.”<sup>25</sup> The legislative history of the 1990 Act, which added section 6038C to the Code, uses the same language.<sup>26</sup>

### ***Explanation of Provision***

The bill modifies the provisions in sections 6038A and 6038C that suspend the statute of limitations to clarify that the suspension applies to any taxable year the determination of the amount of tax imposed for which is affected by the transaction or item to which the summons relates.

It is intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed for the taxable year directly at issue, as well as for any taxable year indirectly affected through, for example, net operating loss carrybacks or carryforwards. It is not intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed for any taxable year other than the taxable year directly at issue solely by reason of any similarity of issues involved. Similarly, it is not intended that, under the provision, a transaction or item would affect the determination of the amount of tax imposed on any taxpayer unrelated to the taxpayer to whom the summons is directed.

<sup>25</sup> H. Rept. No. 247, 101st Cong., 1st Sess. 1301 (1989); “Explanation of Provisions Approved by the Committee on October 3, 1989,” Senate Finance Committee Print, 101st Cong., 1st Sess. 118 (October 12, 1989).

<sup>26</sup> “Legislative History of Ways and Means Democratic Alternative,” House Ways and Means Committee Print (WMCP: 101–37), 101st Cong., 2nd Sess. 58 (October 15, 1990); Report language submitted by the Senate Finance Committee to the Senate Budget Committee on S. 3299, 136 Cong. Rec. S. 15629, S. 15700 (1990).

**d. Rate of interest for large corporate underpayments  
(secs. 1702(c)(6) and (7) of the bill, sec. 11341 of the  
1990 Act, and sec. 6621(c) of the Code)**

***Present Law***

The rate of interest otherwise applicable to underpayments of tax is increased by two percent in the case of large corporate underpayments (generally defined to exceed \$100,000), applicable to periods after the 30th day following the earlier of a notice of proposed deficiency, the furnishing of a statutory notice of deficiency, or an assessment notice issued in connection with a nondeficiency procedure.

***Explanation of Provision***

The bill provides that an IRS notice that is later withdrawn because it was issued in error does not trigger the higher rate of interest. The bill also corrects an incorrect reference to “this subtitle”.

**3. Research credit provision: Effective date for repeal of  
special proration rule (sec. 1702(d)(1) of the bill and sec.  
11402 of the 1990 Act)**

***Present Law***

The Omnibus Budget Reconciliation Act of 1989 (“1989 Act”) effectively extended the research credit for nine months by prorating certain qualified research expenses incurred before January 1, 1991. The special rule to prorate qualified research expenses applied in the case of any taxable year which began before October 1, 1990, and ended after September 30, 1990. Under this special proration rule, the amount of qualified research expenses incurred by a taxpayer prior to January 1, 1991, was multiplied by the ratio that the number of days in that taxable year before October 1, 1990, bears to the total number of days in such taxable year before January 1, 1991. The amendments made by the 1989 Act to the research credit (including the new method for calculating a taxpayer’s base amount) generally were effective for taxable years beginning after December 31, 1989. However, this effective date did not apply to the special proration rule (which applied to any taxable year which began prior to October 1, 1990—including some years which began before December 31, 1989—if such taxable year ended after September 30, 1990).

Section 11402 of the Revenue Reconciliation Act of 1990 (“1990 Act”) extended the research credit through December 31, 1991, and repealed the special proration rule provided for by the 1989 Act. Section 11402 of the 1990 Act was effective for taxable years beginning after December 31, 1989. Thus, in the case of taxable years beginning before December 31, 1989, and ending after September 30, 1990 (e.g., a taxable year of November 1, 1989 through October 31, 1990), the special proration rule provided by the 1989 Act would continue to apply.



### ***Explanation of Provision***

The bill repeals for all taxable years ending after December 31, 1989, the special proration rule provided for by the 1989 Act.

- 4. Energy tax provision: Alternative minimum tax adjustment based on energy preferences (secs. 1702(e)(1) and (4) of the bill, sec. 11531(a) of the 1990 Act, and former sec. 56(h) of the Code)**

### ***Present Law***

In computing alternative minimum taxable income (and the adjusted current earnings (ACE) adjustment of the alternative minimum tax), certain adjustments are made to the taxpayer's regular tax treatment for intangible drilling costs (IDCs) and depletion. For certain taxable years, a special energy deduction is also allowed. The special energy deduction is initially determined by determining the taxpayer's (1) intangible drilling cost preference and (2) the marginal production depletion preference. The intangible drilling cost preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the adjustments for IDCs. The marginal production depletion preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to depletion adjustments attributable to marginal production. The intangible drilling cost preference is then apportioned between (1) the portion of the preference related to qualified exploratory costs and (2) the remaining portion of the preference. The portion of the preference related to qualified exploratory costs is multiplied by 75 percent and the remaining portion is multiplied by 15 percent. The marginal production depletion preference is multiplied by 50 percent. The three products described above are added together to arrive at the taxpayer's special energy deduction (subject to certain limitations).

The special energy deduction is not allowed to the extent that it exceeds 40 percent of alternative minimum taxable income determined without regard to either this special energy deduction or the alternative tax net operating loss deduction. Any special energy deduction amount limited by the 40-percent threshold may not be carried to another taxable year. In addition, the combination of the special energy deduction, the alternative minimum tax net operating loss and the alternative minimum tax foreign tax credit cannot generally offset, in the aggregate, more than 90 percent of a taxpayer's alternative minimum tax determined without such attributes.

The special energy deduction was repealed for taxable years beginning after December 31, 1992.

### ***Explanation of Provision***

#### ***Interaction of special energy deduction with net operating loss and investment tax credit***

The bill clarifies that the amount of alternative tax net operating loss that is utilized in any taxable year is to be appropriately adjusted to take into account the amount of special energy deduction

claimed for that year. This operates to preserve a portion of the alternative tax net operating loss carryover by reducing the amount of net operating loss utilized to the extent of the special energy deduction claimed, which if unused, could not be carried forward.

In addition, the bill contains a similar provision which clarifies that the limitation on the utilization of the investment tax credit for purposes of the alternative minimum tax is to be determined without regard to the special energy deduction.

***Interaction of special energy deduction with adjustment based on adjusted current earnings***

The bill provides that the ACE adjustment for taxable years beginning in 1991 and 1992 is to be computed without regard to the special energy deduction. Thus, the bill specifies that the ACE adjustment is equal to 75 percent of the excess of a corporation's adjusted current earnings over its alternative minimum taxable income computed without regard to either the ACE adjustment, the alternative tax net operating loss deduction, or the special energy deduction.

**5. Estate tax freezes (sec. 1702(f) of the bill, sec. 11602 of the 1990 Act, and secs. 2701–2704 of the Code)**

***Present Law***

***Generally***

The value of property transferred by gift or includible in the decedent's gross estate is its fair market value. Fair market value generally is the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031). Chapter 14 contains rules that supersede the willing buyer, willing seller standard (Code secs. 2701–2704).

***Preferred interests in corporations and partnerships***

***Valuation of retained interests***

*Scope.*—Section 2701 provides special rules for valuing certain rights retained in conjunction with the transfer to a family member of an interest in a corporation or partnership. These rules apply to any applicable retained interest held by the transferor or an applicable family member immediately after the transfer of an interest in such entity. An “applicable family member” is, with respect to any transferor, the transferor's spouse, ancestors of the transferor and the spouse, and spouses of such ancestors.

An applicable retained interest is an interest with respect to which there is one of two types of rights (“affected rights”). The first type of affected right is a liquidation, put, call, or conversion right, generally defined as any liquidation, put, call, or conversion right, or similar right, the exercise or nonexercise of which affects the value of the transferred interest. The second type of affected

right is a distribution right<sup>27</sup> in an entity in which the transferor and applicable family members hold control immediately before the transfer. In determining control, an individual is treated as holding any interest held by the individual's brothers, sisters and lineal descendants. A distribution right does not include any right with respect to a junior equity interest.

*Valuation.*—Section 2701 contains two rules for valuing applicable retained interests. Under the first rule, an affected right other than a right to qualified payments is valued at zero. Under the second rule, any retained interest that confers (1) a liquidation, put, call or conversion right and (2) a distribution right that consists of the right to receive a qualified payment is valued on the assumption that each right is exercised in a manner resulting in the lowest value for all such rights (the “lowest value rule”). There is no statutory rule governing the treatment of an applicable retained interest that confers a right to receive a qualified payment, but with respect to which there is no liquidation, put, call or conversion right.

A qualified payment is a dividend payable on a periodic basis and at a fixed rate under cumulative preferred stock (or a comparable payment under a partnership agreement). A transferor or applicable family member may elect not to treat such a dividend (or comparable payment) as a qualified payment. A transferor or applicable family member also may elect to treat any other distribution right as a qualified payment to be paid in the amounts and at the times specified in the election.

*Inclusion in transfer tax base.*—Failure to make a qualified payment valued under the lowest value rule within four years of its due date generally results in an inclusion in the transfer tax base equal to the difference between the compounded value of the scheduled payments over the compounded value of the payments actually made. The Treasury Department has regulatory authority to make subsequent transfer tax adjustments in the transfer of an applicable retained interest to reflect the increase in a prior taxable gift by reason of section 2701.

Generally, this inclusion occurs if the holder transfers by sale or gift the applicable retained interest during life or at death. In addition, the taxpayer may, by election, treat the payment of the qualified payment as giving rise to an inclusion with respect to prior periods.

The inclusion continues to apply if the applicable retained interest is transferred to an applicable family member. There is no inclusion on a transfer of an applicable retained interest to a spouse for consideration or in a transaction qualifying for the marital deduction, but subsequent transfers by the spouse are subject to the inclusion. Other transfers to applicable family members result in an immediate inclusion as well as subjecting the transferee to subsequent inclusions.

---

<sup>27</sup> Distribution right generally is a right to a distribution from a corporation with respect to its stock, or from a partnership with respect to a partner's interest in the partnership.

*Minimum value of residual interest*

Section 2701 also establishes a minimum value for a junior equity interest in a corporation or partnership. For partnerships, a junior equity interest is an interest under which the rights to income and capital are junior to the rights of all other classes of equity interests.

***Trusts and term interests in property***

The value of a transfer in trust is the value of the entire property less the value of rights in the property retained by the grantor. Section 2702 provides that in determining the extent to which a transfer of an interest in trust to a member of the transferor's family is a gift, the value of an interest retained by the transferor or an applicable family member is zero unless such interest takes certain prescribed forms.

For a transfer with respect to a specified portion of property, section 2702 applies only to such portion. The section does not apply to the extent that the transfer is incomplete.

***Options and buy-sell agreements***

A restriction upon the sale or transfer of property may reduce its fair market value. Treasury regulations provide that a restriction is to be disregarded unless the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than full and adequate consideration (Treas. Reg. sec. 20.2031-2(h)).

Section 2703 provides, that for transfer tax purposes, the value of property is determined without regard to any option, agreement or other right to acquire or use the property at less than fair market value or any restriction on the right to sell or use such property. Certain options are excepted from this rule. To fall within the exception, the option, agreement, right or restriction must (1) be a bona fide business arrangement, (2) not be a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth, and (3) have terms comparable to similar arrangements entered into by persons in an arm's length transaction.

***Explanation of Provision***

***Preferred interests in corporations and partnerships***

*Valuation*

The bill provides that an applicable retained interest conferring a distribution right to qualified payments with respect to which there is no liquidation, put, call, or conversion right is valued without regard to section 2701. The bill also provides that the retention of such right gives rise to potential inclusion in the transfer tax base. In making these changes, it is understood that Treasury regulations could provide, in appropriate circumstances, that a right to receive amounts on liquidation of the corporation or partnership constitutes a liquidation right within the meaning of section 2701 if the transferor, alone or with others, holds the right to cause liquidation.

The bill modifies the definition of junior equity interest by granting regulatory authority to treat a partnership interest with rights that are junior with respect to either income or capital as a junior equity interest. The bill also modifies the definition of distribution right by replacing the junior equity interest exception with an exception for a right under an interest that is junior to the rights of the transferred interest. As a result, section 2701 does not affect the valuation of a transferred interest that is senior to the retained interest, even if the retained interest is not a junior equity interest.

The bill modifies the rules for electing into or out of qualified payment treatment. A dividend payable on a periodic basis and at a fixed rate under a cumulative preferred stock held by the transferor is treated as a qualified payment unless the transferor elects otherwise. If held by an applicable family member, such stock is not treated as a qualified payment unless the holder so elects.<sup>28</sup> In addition, a transferor or applicable family member holding any other distribution right may treat such right as a qualified payment to be paid in the amounts and at the times specified in the election.

#### *Inclusion in transfer tax base*

The bill grants the Treasury Department regulatory authority to make subsequent transfer tax adjustments to reflect the inclusion of unpaid amounts with respect to a qualified payment. This authority, for example, would permit the Treasury Department to eliminate the double taxation that might occur if, with respect to a transfer, both the inclusion and the value of qualified payment arrearages were included in the transfer tax base. It also would permit elimination of the double taxation that might result from a transfer to a spouse, who, under the statute, is both an applicable family member and a member of the transferor's family.

The bill treats a transfer to a spouse falling under the annual exclusion the same as a transfer qualifying for the marital deduction. Thus, no inclusion would occur upon the transfer of an applicable retained interest to a spouse, but subsequent transfers by the spouse would be subject to inclusion. The bill also clarifies that the inclusion continues to apply if an applicable family member transfers a right to qualified payments to the transferor.

The provision clarifies the consequences of electing to treat a distribution as giving rise to an inclusion. Under the bill, the election gives rise to an inclusion only with respect to the payment for which the election is made. The inclusion with respect to other payments is unaffected.

#### ***Trust and term interests in property***

The bill conforms section 2702 to existing regulatory terminology by substituting the term "incomplete gift" for "incomplete transfer." In addition, the bill limits the exception for incomplete gifts to instances in which the entire gift is incomplete. The Treasury Department is granted regulatory authority, however, to create additional exceptions not inconsistent with the purposes of the section.

<sup>28</sup> With respect to gifts made prior to the date of enactment, the provision provides that this election may be made by the due date (including extensions) of the transferor's gift tax return due for the first calendar year after the date of enactment.

This authority, for example, could be used to except a charitable remainder trust that meets the requirements of section 664 and that does not otherwise create an opportunity for transferring property to a family member free of transfer tax.

## **6. Miscellaneous provisions**

### **a. Conforming amendments to the repeal of the *General Utilities* doctrine (secs. 1702(g)(1) and (2) of the bill, sec. 11702(e)(2) of the 1990 Act, and secs. 897(f) and 1248 of the Code)**

#### ***Present Law***

As a result of changes made by recent tax legislation, gain is generally recognized on the distribution of appreciated property by a corporation to its shareholders. The Technical Corrections subtitle of the 1990 Act and technical correction provisions in prior acts made various conforming amendments arising out of these changes. For example, the 1990 Act made a conforming change to section 355(c) to state the treatment of distributions in section 355 transactions in the affirmative rather than by reference to the provisions of section 311. In addition, the Technical and Miscellaneous Revenue Act of 1988 (“1988 Act”) made a conforming change to section 1248(f) to update the references to the nonrecognition provisions contained in that subsection. One of the changes was to change the reference to “section 311(a)” from “section 311”.

#### ***Explanation of Provision***

The bill makes three conforming changes to the Code with respect to the repeal of the *General Utilities* doctrine.

First, section 1248(f) is amended to add a reference to section 355(c)(1), which provides generally for the nonrecognition of gain or loss on the distribution of stock or securities in certain subsidiary corporations. This retains the substance of the law as it existed before the conforming change to section 355(c) made by the 1990 Act. This provision is not intended to affect the authority of the Secretary of the Treasury to issue regulations under section 1248(f) providing exceptions to the rule recognizing gain in certain distributions (cf. Notice 87-64, 1987-2 C.B. 375).

Second, section 1248 is amended to clarify that, notwithstanding the conforming changes made by the 1988 Act, with respect to any transaction in which a U.S. person is treated as realizing gain from the sale or exchange of stock of a controlled foreign corporation, the U.S. person shall be treated as having sold or exchanged the stock for purposes of applying section 1248. Thus, if a U.S. person distributes appreciated stock of a controlled foreign corporation to its shareholders in a transaction in which gain is recognized under section 311(b), section 1248 shall be applied as if the stock had been sold or exchanged at its fair market value. Under section 1248(a), part or all of the gain may be treated as a dividend. Under the bill, the rule treating the distribution for purposes of section 1248 as a sale or exchange also applies where the U.S. person is deemed to distribute the stock under the provisions of section

1248(i). Under section 1248(i), gain will be recognized only to the extent of the amount treated as a dividend under section 1248.

Third, section 897(f), relating to the basis in a United States real property interest distributed to a foreign person, is repealed as deadwood. The basis of the distributed property is its fair market value in accordance with section 301(d).

**b. Prohibited transaction rules (sec. 1702(g)(3) of the bill, sec. 11701(m) of the 1990 Act, and sec. 4975 of the Code)**

***Present Law***

The Code and title I of the Employee Retirement Income Security Act of 1974 (ERISA) prohibit certain transactions between an employee benefit plan and certain persons related to such plan. An exemption to the prohibited transaction rules of title I of ERISA is provided in the case of sales of employer securities the plan is required to dispose of under the Pension Protection Act of 1987 (ERISA sec. 408(b)(12)). The 1990 Act amended the Code to provide that certain transactions that are exempt from the prohibited transaction rules of ERISA are automatically exempt from the prohibited transaction rules of the Code. The 1990 Act change was intended to be limited to transactions exempt under section 408(b)(12) of ERISA.

***Explanation of Provision***

The bill conforms the statutory language to legislative intent by providing that transactions that are exempt from the prohibited transaction rules of ERISA by reason of ERISA section 408(b)(12) are also exempt from the prohibited transaction rules of the Code.

**c. Effective date of LIFO adjustment for purposes of computing adjusted current earnings (sec. 1702(g)(4) of the bill, sec. 11701 of the 1990 Act, sec. 7611(b) of the 1989 Act, and sec. 56(g) of the Code)**

***Present Law***

For purposes of computing the adjusted current earnings (ACE) component of the corporate alternative minimum tax, taxpayers are required to make the LIFO inventory adjustments provided in section 312(n)(4) of the Code. Section 312(n)(4) generally is applicable for purposes of computing earnings and profits in taxable years beginning after September 30, 1984. The ACE adjustment generally is applicable to taxable years beginning after December 31, 1989.

***Explanation of Provision***

The bill clarifies that the LIFO inventory adjustment required for ACE purposes shall be computed by applying the rules of section 312(n)(4) only with respect to taxable years beginning after December 31, 1989. The effective date applicable to the determination of earnings and profits (September 30, 1984) is inapplicable for purposes of the ACE LIFO inventory adjustment. Thus, the ACE LIFO adjustment shall be computed with reference to increases

(and decreases, to the extent provided in Treasury regulations) in the ACE LIFO reserve in taxable years beginning after December 31, 1989.

**d. Low-income housing tax credit (sec. 1702(g)(5) of the bill, sec. 11701(a)(11) of the 1990 Act, and sec. 42 of the Code)**

***Present Law***

The amendments to the low-income housing tax credit contained in the Omnibus Budget Reconciliation Act of 1989 ("1989 Act") generally were effective for buildings placed in service after December 31, 1989, to the extent the buildings were financed by tax-exempt bonds ("bond-financed buildings"). This rule applied regardless of when the bonds were issued.

A technical correction enacted in the Revenue Reconciliation Act of 1990 ("1990 Act") limited this effective date to buildings financed with bonds issued after December 31, 1989. Thus, the technical correction applied pre-1989 Act law to bond-financed buildings placed in service after December 31, 1989, if the bonds were issued before January 1, 1990.

***Explanation of Provision***

The bill repeals the 1990 technical correction. The bill provides, however, that pre-1989 Act law will apply to a bond-financed building if the owner of the building establishes to the satisfaction of the Secretary of the Treasury reasonable reliance upon the 1990 technical correction. In the case of buildings placed in service before the date of the bill's enactment, reasonable reliance may be established by a showing of compliance with the law as in effect for those buildings before enactment of the amendments made by the bill.

**7. Expired or obsolete provisions ("deadwood provisions") (secs. 1702(h)(1)–(18) of the bill and secs. 11801–11816 of the 1990 Act)**

***Present Law***

The 1990 Act repealed and amended numerous sections of the Code by deleting obsolete provisions ("deadwood"). These amendments were not intended to make substantive changes to the tax law.

***Explanation of Provision***

The bill makes several amendments to restore the substance of prior law which was inadvertently changed by the deadwood provisions of the 1990 Act. These amendments include (1) a provision that clarifies that solar or wind property owned by a public utility may qualify as 5-year MACRS property (sec. 168(e)(3)(B)(vi)) and (2) a provision restoring the prior-law rule providing that if any member of an affiliated group of corporations elects the credit under section 901 for foreign taxes paid or accrued, then all members of the group paying or accruing such taxes must elect the credit in order for any dividend paid by a member of the group to



qualify for the 100-percent dividends received deduction (sec. 243(b)).

The bill also makes several nonsubstantive clerical amendments to conform the Code to the amendments made by the deadwood provisions. None of these amendments is intended to change the substance of pre-1990 law.

## **B. Technical Corrections to the Revenue Reconciliation Act of 1993**

### **1. Treatment of full-time students under the low-income housing credit (sec. 1703(b)(1) of the bill, sec. 13142 of the 1993 Act and sec. 42 of the Code)**

#### ***Present Law***

The Revenue Reconciliation Act of 1993 ("1993 Act") codified prior law rules relating to the treatment of married students filing joint returns. Further, it provided that a housing unit occupied entirely by full-time students may qualify for the credit if the full-time students are a single parent and his or her minor children and none of the tenants is a dependent of a third party.

#### ***Explanation of Provision***

The bill provides that the full-time student provision is effective on the date of enactment of the 1993 Act.

### **2. Indexation of threshold applicable to excise tax on luxury automobiles (sec. 1703(c) of the bill, sec. 13161 of the 1993 Act, and sec. 4001(e)(1) of the Code)**

#### ***Present Law***

The 1993 Act indexed the threshold above which the excise tax on luxury automobiles is to apply.

#### ***Explanation of Provision***

The bill corrects the application of the indexing adjustment so that the adjustment calculated for a given calendar year applies for that calendar year rather than in the subsequent calendar year. This conforms the indexation to that described in the conference report to the 1993 Act.<sup>29</sup> The intent of Congress, as reflected in the conference report, was that current year indexation be effective on the date of enactment of the 1993 Act. Under the bill, the provision would, however, be effective on the date of enactment, to alleviate the difficulties that both taxpayers and the Treasury would experience in administering a retroactive refund effective to August 10, 1993.

---

<sup>29</sup> See, H. Rept. 103-213, August 4, 1993, p. 558.

**3. Indexation of the limitation based on modified adjusted gross income for income from United States Savings bonds used to pay higher education tuition and fees (sec. 1703(d) of the bill, sec. 13201 of the 1993 Act, and sec. 135(b)(2)(B) of the Code)**

***Present Law***

A taxpayer may exclude from gross income the proceeds from the redemption of qualified United States savings bonds if the proceeds are used to pay qualified higher education expenses and the taxpayer's modified adjusted gross income is equal to or less than \$60,000 (\$40,000 in the case of a single return). The exclusion is phased out for incomes above these thresholds. The \$60,000 (\$40,000) threshold is indexed for inflation occurring after 1992.

***Explanation of Provision***

The bill corrects the indexing of the \$60,000 (\$40,000) threshold to provide that the thresholds be indexed for inflation after 1989, as was provided prior to the 1993 Act.

**4. Reporting and notification requirements for lobbying and political expenditures of tax-exempt organizations (sec. 1703(g) of the bill, sec. 13222 of the 1993 Act and sec. 6033(e) of the Code)**

***Present Law***

Tax-exempt organizations which incur political expenditures are subject to tax under Code section 527(f). The tax is calculated by applying the highest corporate rate to the lesser of (a) the net investment income of the organization, or (b) the amount of political expenditures incurred by the organization during the taxable year. Expenditures covered by Code section 527(f) are those expended for "influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed."

Code section 162(e), as amended by the 1993 Act, provides a separate set of rules regarding the tax treatment of lobbying and political expenditures. Political expenditures include amounts paid or incurred in connection with "participation in, or intervention in, any political campaign on behalf of (or in opposition to) any candidate for public office." Taxpayers may not deduct the portion of dues or similar amounts paid to a tax-exempt organization which the organization notifies the taxpayer are allocable to lobbying or political expenditures.

Code section 6033(e) sets forth reporting and notification requirements applicable to tax-exempt organizations (other than charities) that incur lobbying or political expenditures within the meaning of Code section 162(e). First, the organization must report on its annual tax return both the total amount of its lobbying and political expenditures, and the total amount of dues (or similar payments) allocable to such expenditures. Second, the organization must ei-

ther provide notice to its members of the portion of dues allocable to lobbying and political expenditures (so that such amounts are not deductible by members), or may elect to pay a proxy tax (at the highest corporate rate) on its lobbying and political expenditures, up to the amount of dues receipts.

### ***Explanation of Provision***

The bill amends Code section 6033(e) to clarify that any political expenditures on which tax is paid pursuant to Code section 527(f) are not subject to the reporting and notification requirements of Code section 6033(e). In addition, the bill clarifies that the reporting and notification requirements of Code section 6033(e) apply to organizations exempt from tax under Code section 501(a), other than charities described in section 501(c)(3).

### **5. Estimated tax rules for certain tax-exempt organizations (sec. 1703(h) of the bill, sec. 13225 of the 1993 Act and sec. 6655(g)(3) of the Code)**

#### ***Present Law***

A tax-exempt organization is generally subject to an addition to tax for any underpayment of estimated tax on its unrelated business taxable income or its net investment income (as the case may be). Under the 1993 Act, for years beginning after December 31, 1993, a corporation or tax-exempt organization does not have an underpayment of estimated tax if it makes four timely estimated tax payments that total at least 100 percent of the tax liability shown on its return for the current taxable year. A corporation or tax-exempt organization may estimate its current year tax liability prior to year-end by annualizing its income. The 1993 Act also changed the method by which a corporation annualizes its current year tax liability.

### ***Explanation of Provision***

The bill clarifies that the 1993 Act did not change the method by which a tax-exempt organization annualizes its current year tax liability.

### **6. Current taxation of certain earnings of controlled foreign corporations—application of foreign tax credit limitation (sec. 1703(i)(1) of the bill, sec. 13231(b) of the 1993 Act, and sec. 904(d) of the Code)**

#### ***Present Law***

Present law requires U.S. shareholders of a controlled foreign corporation to include in income the corporation's subpart F income, certain earnings invested in U.S. property, and, as modified by the 1993 Act, certain earnings invested in excess passive assets. A U.S. shareholder's tax liability attributable to the inclusion may be offset by foreign tax credits for certain foreign taxes paid or deemed paid by the shareholder.

The foreign tax credit limitation applies separately to several categories of income. The separate limitations apply to a dividend

from a controlled foreign corporation to a U.S. shareholder of that controlled foreign corporation by reference to the character of the earnings and profits of the distributing corporation.

An inclusion of a controlled foreign corporation's earnings invested in U.S. property is treated like a dividend for purposes of the foreign tax credit limitation. Although the 1993 Act provided that inclusions of earnings invested in excess passive assets generally are determined in the same manner as inclusions of earnings invested in U.S. property, the 1993 Act did not specify how the separate limitations of the foreign tax credit should apply to inclusions of earnings invested in excess passive assets.

Some have argued that the separate limitations of the foreign tax credit do not apply to an inclusion of a controlled foreign corporation's earnings invested in excess passive assets; rather, that such an inclusion is allocated entirely to the general foreign tax credit limitation, without regard to the character of the underlying earnings and profits of the controlled foreign corporation.

#### ***Explanation of Provision***

The bill clarifies that a U.S. shareholder's inclusion of a controlled foreign corporation's earnings invested in excess passive assets is treated like a dividend for purposes of the foreign tax credit limitation. Thus, the inclusion is characterized by reference to the underlying earnings and profits of the controlled foreign corporation. This treatment is consistent with present law's application of the separate limitations of the foreign tax credit to other amounts included in income with respect to a controlled foreign corporation.

#### **7. Current taxation of certain earnings of controlled foreign corporations—measurement of accumulated earnings (sec. 1703(i)(2) of the bill, sec. 13231(b) of the 1993 Act, and sec. 956A(b) of the Code)**

##### ***Present Law***

Present law, as modified by the 1993 Act, limits the availability of deferral of U.S. tax on certain earnings of controlled foreign corporations by requiring U.S. shareholders of a controlled foreign corporation to include in income the corporation's accumulated<sup>30</sup> or current earnings invested in excess passive assets. Some have argued that the Code's definition of earnings subject to this treatment permits an accumulated deficit in earnings to eliminate positive current earnings, resulting in no income inclusion in a case where an actual distribution would be treated as a dividend out of current earnings. In addition, some have argued that the Code's definition of earnings subject to this treatment takes current-year earnings into account more than once.

#### ***Explanation of Provision***

The bill clarifies that the accumulated earnings and profits of a controlled foreign corporation taken into account for purposes of determining the foreign corporation's earnings invested in excess pas-

<sup>30</sup> Accumulated earnings and profits are taken into account only to the extent that they were accumulated in taxable years beginning after September 30, 1993.

sive assets do not include any deficit in accumulated earnings and profits,<sup>31</sup> and do not include current earnings (which are taken into account separately).

**8. Current taxation of certain earnings of controlled foreign corporations—aggregation and look-through rules (sec. 1703(i)(3) of the bill, sec. 13231(b) of the 1993 Act, and sec. 956A(f) of the Code)**

***Present Law***

Present law, as modified by the 1993 Act, provides certain aggregation and look-through rules in connection with requiring U.S. shareholders of a controlled foreign corporation to include in income certain of the corporation's earnings invested in excess passive assets. Under the aggregation rule, certain groups of controlled foreign corporations that are linked by stock ownership of more than 50 percent (CFC groups) are treated as a single corporation for purposes of determining their earnings invested in excess passive assets. Look-through treatment applies to certain corporations whose stock is owned at least 25 percent by a controlled foreign corporation. Some have argued that these rules permit the assets of one foreign corporation to be taken into account more than once through a combination of CFC group treatment and look-through treatment. In addition, some have argued that these rules permit the assets of one foreign corporation to be taken into account more than once through membership of the foreign corporation in more than one CFC group.

***Explanation of Provision***

The bill clarifies that, within the regulatory authority provided to the Secretary of the Treasury under the 1993 Act, regulations are specifically authorized to coordinate the CFC group treatment and look-through treatment applicable for purposes of determining a foreign corporation's earnings invested in excess passive assets. Pending the promulgation of guidance by the Secretary, it is intended that taxpayers be permitted to coordinate such treatment using any reasonable method for taking assets into account only once, so long as the method is consistently applied to all controlled foreign corporations (whether or not members of any CFC group) in all taxable years.

**9. Treatment of certain leased assets for PFIC purposes (sec. 1703(i)(5) of the bill, sec. 13231(d)(4) of the 1993 Act, and sec. 1297(d) of the Code)**

***Present Law***

Under present law, as modified by the 1993 Act, certain property leased by a foreign corporation may be treated as an asset actually owned by the foreign corporation in measuring the assets of the foreign corporation for purposes of the passive foreign investment company ("PFIC") asset test of section 1296(a)(2). The 1993 Act provided a special measurement rule, under which the adjusted

<sup>31</sup> Incurred in taxable years beginning after September 30, 1993.

basis of the leased asset for this purpose is determined by reference to the unamortized portion of the present value of the payments under the lease for the use of the property. Some have argued, however, that the special measurement rule does not apply to PFICs that are permitted to measure their assets by fair market value, rather than by adjusted basis. Under this argument, the entire fair market value of the leased asset might be treated as owned by the foreign corporation.

### ***Explanation of Provision***

The bill clarifies that, in the case of any item of property leased by a foreign corporation and treated as an asset actually owned by the foreign corporation in measuring the assets of the foreign corporation for purposes of the PFIC asset test, the amount taken into account with respect to the leased property is the amount determined under the 1993 Act's special measurement rule, which is based on the unamortized portion of the present value of the payments under the lease for the use of the property. That is, the provision clarifies that the special measurement rule of the 1993 Act applies to all PFICs, regardless of whether they are generally permitted to measure their assets by fair market value rather than adjusted basis.

## **10. Amortization of goodwill and certain other intangibles (sec. 1703(k) of the bill, sec. 13261(g) of the 1993 Act, and sec. 197 of the Code)**

### ***Present Law***

The 1993 Act allows amortization deductions to certain intangible assets acquired after the 1993 Act's effective date that were not amortizable under prior law. The 1993 Act contains "antichurning" rules that deny amortization to intangible assets that were not amortizable under prior law if such assets are acquired by the taxpayer after the effective date from certain related parties.

The 1993 Act also contains an election under which a taxpayer and certain related parties may elect to treat all acquisitions after July 25, 1991 as subject to the provisions of the 1993 Act.

### ***Explanation of Provision***

The bill clarifies that when a taxpayer and its related parties have made an election to apply the 1993 Act to all acquisitions after July 25, 1991, the antichurning rules will not apply when property acquired from an unrelated party after July 25, 1991 (and not subject to the antichurning rules in the hands of the acquirer) is transferred to a taxpayer related to the acquirer after the date of enactment of the 1993 Act.

**11. Empowerment zones and eligibility of small farms for tax incentives (sec. 1703(l) of the bill, sec. 13301 of the 1993 Act, and sec. 1397B(d)(5)(B) of the Code)**

***Present Law***

Pursuant to the 1993 Act, on December 21, 1994, six empowerment zones and 65 enterprise communities were designated in eligible urban areas, and three empowerment zones and 30 enterprise communities were designated in rural areas. Special tax incentives (i.e., a wage credit, additional section 179 expensing, and expanded tax-exempt financing) are available for certain business activities conducted in urban and rural empowerment zones. Expanded tax-exempt financing benefits are available for certain facilities located in urban and rural enterprise communities.

The empowerment zone wage credit is not available with respect to any individual employed by a trade or business the principal activity of which is farming (within the meaning of subparagraphs (A) and (B) of section 2032A(e)(5)) if, as of the close of the current taxable year, the sum of the aggregate unadjusted bases (or, if greater, the fair market value) of assets of the farm exceed \$500,000 (sec. 1396(d)(2)(E)). In contrast, the additional section 179 expensing (available in empowerment zones) and expanded tax-exempt financing benefits (available in both empowerment zones and enterprise communities) are not allowed for any trade or business the principal activity of which is farming if, as of the close of the preceding taxable year, the sum of the aggregate bases (or, if greater, the fair market value) of the assets of the farm exceed \$500,000 (sec. 1397B(d)(5)).

***Explanation of Provision***

The bill provides that the \$500,000 asset test for determining whether a farm is eligible for additional section 179 expensing (in an empowerment zone) and expanded tax-exempt financing benefits (in an empowerment zone or enterprise community) is applied based on the assets of the farm at the end of the current taxable year. Thus, the \$500,000 asset test for determining farm eligibility is based on the same taxable period (i.e., the current taxable year) for purposes of all tax incentives available in empowerment zones and enterprise communities.

**C. Other Tax Technical Corrections**

**1. Hedge bonds (sec. 1704(b) of the bill, sec. 11701 of the 1989 Act, and sec. 149(g) of the Code)**

***Present Law***

The 1989 Act provided generally that interest on hedge bonds is not tax-exempt unless prescribed minimum percentages of the proceeds are reasonably expected to be spent at set intervals during the five-year period after issuance of the bonds (sec. 149(g)). A hedge bond is defined generally as a bond (1) at least 85 percent of the proceeds of which is not reasonably expected to be spent within three years following issuance and (2) more than 50 percent

of the proceeds of which is invested at substantially guaranteed yields for four years or more.

This restriction does not apply, however, if at least 95 percent of the bond proceeds is invested in other tax-exempt bonds (not subject to the alternative minimum tax). The 95-percent investment requirement is not violated if investment earnings exceeding five percent of the proceeds are temporarily invested for up to 30 days pending reinvestment in taxable (including alternative minimum taxable) investments.

This provision is effective as if included in the Omnibus Budget Reconciliation Act of 1989.

### ***Explanation of Provision***

The bill clarifies that the 30-day exception for temporary investments of investment earnings applies to amounts (i.e., principal and earnings thereon) temporarily invested during the 30-day period immediately preceding redemption of the bonds as well as such periods preceding reinvestment of the proceeds.

## **2. Withholding on distributions from U.S. real property holding companies (sec. 1704(c) of the bill, sec. 129 of the Deficit Reduction Act of 1984, and sec. 1445 of the Code)**

### ***Present Law***

#### ***In general***

Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), a foreign investor that disposes of a U.S. real property interest generally is required to pay tax on any gain on the disposition. For this purpose a U.S. real property interest generally includes stock in a domestic corporation that is a U.S. real property holding corporation ("USRPHC"), or was a USRPHC at any time during the previous five years.

A sale or exchange of stock in a USRPHC is an example of a disposition of a U.S. real property interest. In addition, provisions of subchapter C of the Code treat amounts received in certain corporate distributions as amounts received in sales or exchanges, giving rise to tax liability under the FIRPTA rules when a foreign person receives such a distribution from a present or former USRPHC. Thus, amounts received by a foreign shareholder in a USRPHC in a distribution in complete liquidation of the USRPHC are treated as in full payment in exchange for the USRPHC stock, and are therefore subject to tax under FIRPTA (sec. 331; Treas. Reg. sec. 1.897-5T(b)(2)(iii)). Similarly, amounts received by a foreign shareholder in a USRPHC upon redemption of the USRPHC stock are treated as a distribution in part or full payment in exchange for the stock, and are therefore subject to tax under FIRPTA (sec. 302(a); Treas. Reg. sec. 1.897-5T(b)(2)(ii)). Third, amounts received by a foreign shareholder in a USRPHC, in a section 301 distribution from the USRPHC that exceeds the available earnings and profits of the USRPHC, are treated as gain from the sale or exchange of the shareholder's USRPHC stock to the extent that they exceed the shareholder's adjusted basis in the stock; such amounts



are therefore also subject to tax under FIRPTA (sec. 301(c)(3); Treas. Reg. sec. 1.897-5T(b)(2)(i)).

### ***FIRPTA withholding***

The Deficit Reduction Act of 1984 established a withholding system to enforce the FIRPTA tax. Unless an exception applies, a transferee of a U.S. real property interest from a foreign person generally is required to withhold the lesser of 10 percent of the amount realized (purchase price), or the maximum tax liability on disposition (as determined by the IRS) (sec. 1445). Such withholding may be reduced or eliminated pursuant to a withholding certificate issued by the Internal Revenue Service (Treas. Reg. sec. 1.1445-3).

Although the FIRPTA withholding requirement by its terms generally applies to all dispositions of U.S. real property interests, and subchapter C treats amounts received in certain distributions as amounts received in sales or exchanges, the FIRPTA withholding provisions also provide express rules for withholding on certain distributions treated as sales or exchanges. Generally, distributions in a transaction to which section 302 (redemptions) or part II of subchapter C (liquidations) applies are subject to 10-percent withholding.<sup>32</sup> Although a section 301 distribution in excess of earnings and profits is also treated as a disposition for purposes of computing the FIRPTA liability of a foreign recipient of the distribution, there is no corresponding withholding provision expressly addressed to the payor of such a distribution.

### ***Explanation of Provision***

The bill clarifies that FIRPTA withholding requirements apply to any section 301 distribution to a foreign person by a domestic corporation that is or was a USRPHC, which distribution is not made out of the corporation's earnings and profits and is therefore treated as an amount received in a sale or exchange of a U.S. real property interest. (The bill does not alter the withholding treatment of section 301 distributions by such a corporation that are out of earnings and profits.) Under the bill, the FIRPTA withholding requirements that apply to a section 301 distribution not out of earnings and profits are similar to the requirements applicable to redemption or liquidation distributions to a foreign person by such a corporation. It is anticipated that withholding certificates will be available to taxpayers that expect to receive section 301 distributions not out of earnings and profits.

The provision is effective for distributions made after the date of enactment of the bill. No inference is intended to be drawn from the provision as to the FIRPTA withholding requirements applicable to such a distribution under present law.

<sup>32</sup> Under other rules, dividend distributions (i.e., distributions to which sec. 301(c)(1) applies) to foreign persons by U.S. corporations, including USRPHCs, are subject to 30-percent withholding under the Code. Under treaties, the withholding on a dividend may be reduced to as little as 5 or 15 percent.

**3. Treatment of credits attributable to working interests in oil and gas properties (sec. 1704(d) of the bill, sec. 501 of the Tax Reform Act of 1986, and sec. 469 of the Code)**

***Present Law***

Under present law, a working interest in an oil and gas property which does not limit the liability of the taxpayer is not a "passive activity" for purposes of the passive loss rules (sec. 469). However, if any loss from an activity is treated as not being a passive loss by reason of being from a working interest, any net income from the activity in subsequent years is not treated as income from a passive activity, notwithstanding that the activity may otherwise have become passive with respect to the taxpayer.

***Explanation of Provision***

The bill clarifies that any credit attributable to a working interest in an oil and gas property, in a taxable year in which the activity is no longer treated as not being a passive activity, will not be treated as attributable to a passive activity to the extent of any tax allocable to the net income from the activity for the taxable year. Any credits from the activity in excess of this amount of tax will continue to be treated as arising from a passive activity and will be treated under the rules generally applicable to the passive activity credit. The provision applies to taxable years beginning after December 31, 1986.

**4. Clarification of passive loss disposition rule (sec. 1704(e) of the bill, sec. 501 of the Tax Reform Act of 1986, sec. 1005(a)(2)(A) of the Technical and Miscellaneous Revenue Act of 1988, and sec. 469(g)(1)(A) of the Code)**

***Present Law***

The Tax Reform Act of 1986 ("1986 Act") provided that if a passive activity is disposed of in a transaction in which all gain or loss is recognized, any overall loss from the activity in the year of disposition is recognized and allowed against income (whether active or passive income).<sup>33</sup> The language of the 1986 Act provided that any loss was allowable, first, against income or gain from the passive activity, second, against income or gain from all passive activities, and finally, against any other income or gain. This rule was rewritten by the technical corrections portion of the Technical and Miscellaneous Revenue Act of 1988 ("1988 Act"). The statutory language (as amended by the 1988 Act) providing for the computation of the overall loss for the taxable year of disposition is not entirely clear where the activity is disposed of at a gain.

***Explanation of Provision***

The bill clarifies the rule relating to the computation of the overall loss allowed upon the disposition of a passive activity. The bill provides that, in a transaction in which all gain or loss is recognized on the disposition of a passive activity, any loss from the activity for the taxable year (taking into account all income, gain, and loss, including gain or loss recognized on the disposition) in excess

of any net income or gain from other passive activities for the taxable year is treated as a loss which is not from a passive activity. The provision applies to taxable years beginning after December 31, 1986.

**5. Estate tax unified credit allowed nonresident aliens under treaty (sec. 1704(f)(1) of the bill, sec. 5032(b)(2) of the Technical and Miscellaneous Revenue Act of 1988, and sec. 2102(c)(3)(A) of the Code)**

***Present Law***

***Amount subject to tax***

For U.S. citizens and residents, the amount subject to Federal estate and gift tax is determined by reference to all property, wherever situated. For nonresident aliens, the Code provides that the amount subject to Federal estate and gift tax is determined only by reference to property situated in the United States.

The United States has entered into bilateral treaties designed to avoid double transfer taxation. Early treaties typically did this by providing rules for determining situs and requiring that the State of domicile allow a credit for taxes paid to the situs country.<sup>34</sup> In contrast, treaties signed in the 1980s, and the U.S. and OECD model treaties, exempt most property, wherever situated, from taxation outside the State of domicile.<sup>35</sup>

<sup>35</sup>See, e.g., U.S. Treasury Model Estate and Gift Tax Treaty (1980), Article 7, paragraph 1: "Transfers and deemed transfers by an individual domiciled in a Contracting State of property other than property referred to in Article 5 (Real Property) and 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) shall be taxable only in that State."

***Specific exemption and unified credit***

Prior to the Tax Reform Act of 1976 ("1976 Act"), the Code allowed a "specific exemption" against the estate tax. The estate of a U.S. citizen or resident was allowed an exemption of \$60,000, while the estate of a nonresident alien was allowed a lesser amount. A number of U.S. estate tax treaties ratified in the 1950s allowed a nonresident alien a "specific exemption" equal to the exemption allowed a U.S. citizen or resident multiplied by the percentage of the gross estate subject to U.S. estate tax (the "pro rata exemption").<sup>36</sup>

The 1976 Act replaced the specific exemption with a unified credit of \$47,000 for the estate of U.S. citizen or resident and \$3,600 for the estate of a nonresident alien. After 1976, two courts interpreted the pro rata exemption allowed in the 1950s treaties as applying to the unified credit, i.e., as allowing a unified credit no less than the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate situated in the United States (and therefore subject to U.S. estate tax under those treaties).<sup>37</sup>

The Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") increased the unified credit allowed an estate of a non-

<sup>33</sup>See S. Rept. 99-313, p. 725.

<sup>34</sup>See Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., *Explanation of Proposed Estate and Gift Tax Treaty Between the United States and Sweden* 8 (1984).

<sup>36</sup>See Rev. Rul. 81-303, 1981-2 C.B. 255.

<sup>37</sup>See *Mudry v. United States*, 11 Cl. Ct. 207 (1986) (Swiss treaty); *Burghardt v. Commissioner*, 80 T.C. 705 (1983), aff'd., 734 F.2d 3 (3d Cir. 1984) (Italian treaty).

resident alien to \$13,000. In so doing, the 1988 Act provided that, “to the extent required by any treaty,” the estate of a nonresident alien is allowed a unified credit equal to the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate situated in the United States (Code sec. 2102(c)(3)(A)). Thus, the 1988 Act did not override the “specific exemption” language of the 1950s treaties, as interpreted by the two courts, and could be interpreted as encouraging the negotiation of pro rata unified credits in future treaties.

### ***Explanation of Provision***

The bill clarifies that in determining the pro rata unified credit required by treaty, property exempted by the treaty from U.S. estate tax is not treated as situated in the United States. Under this rule, a treaty granting a pro rata unified credit would allow a nonresident alien the unified credit allowed a U.S. citizen or resident multiplied by the percentage of the gross estate subject to U.S. estate tax, as modified by treaty.

The bill is not intended to affect existing treaties that contain pro rata exemptions pursuant to which the assets reserved for situs taxation by the non-domiciliary country are specifically described. In the case of a treaty that contains pro rata exemption but does not provide rules for determining the situs for property (e.g., the treaty with Canada), the bill clarifies that property exempted by the treaty from U.S. estate tax is not treated as situated in the United States. For future treaties, it is intended that any pro rata unified credit negotiated not exceed the proportion of the gross worldwide estate subject to U.S. estate and gift tax, as modified by treaty.

The provision is effective upon the date of its enactment.

### **6. Limitation on deduction for certain interest paid by corporation to related persons (sec. 1704(f)(2)(A) of the bill, sec. 7210(a) of the 1989 Act, and sec. 163(j) of the Code)**

#### ***Present Law***

Subject to certain limitations, a taxpayer may deduct interest paid or accrued on indebtedness within a taxable year (sec. 163(a)). The 1989 Act added a so-called “earnings stripping” limitation on interest deductibility with respect to certain interest paid by corporations to related persons (sec. 163(j)). If the provision applies to a corporation for a taxable year, it disallows deductions for certain amounts of “disqualified interest” paid or accrued by the corporation during that year. If in a taxable year a deduction is disallowed, under the provision, for an amount of interest paid or accrued in that year, the disallowed amount is treated under the earnings stripping provision as disqualified interest paid or accrued in the succeeding taxable year.<sup>38</sup>

In order for the earnings stripping provision to apply to a corporation for a taxable year, two thresholds must be exceeded. To

<sup>38</sup> Disqualified interest is interest paid by a corporation to related persons that are not subject to U.S. tax on the interest received. (If, in accordance with a U.S. income tax treaty, interest income of a related person is subject to a reduced rate of U.S. tax, a portion of the interest paid to the related person is deemed to be interest on which no tax is imposed.)

exceed the first threshold, the corporation must have “excess interest expense” as that term is defined in the Code for this purpose. To exceed the second threshold, the corporation must have a ratio of debt to equity as of the close of the taxable year in question (or on any other day prescribed by the Secretary in regulations) that exceeds 1.5 to 1. Excess interest expense is the excess (if any) of the corporation’s net interest expense over the sum of 50 percent of the adjusted taxable income of the corporation plus any excess limitation carryforward from a prior year. Excess limitation is the excess (if any) of 50 percent of adjusted taxable income over net interest expense.

### ***Explanation of Provision***

The bill provides that the debt-equity threshold does not apply for purposes of applying the earnings stripping provision to a carryover of excess interest expense from a prior taxable year. Thus, the bill clarifies that excess interest carried forward from a year in which the debt-equity ratio threshold is exceeded may be deducted in a subsequent year in which that threshold is not exceeded, but only to the extent that such interest would not otherwise be treated as excess interest expense in the carryforward year.

For example, assume that in year 1 \$20 of a corporation’s interest expense is nondeductible due to the operation of the earnings stripping provision. The corporation carries forward the \$20 of interest deduction that it could not use in year 1. Assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and \$50 of current net and gross interest expense, all of which is disqualified interest, and that it earns \$400 of adjusted taxable income. The bill is intended to clarify that the \$20 of interest carried forward from year 1 is deductible in year 2. This is because \$70, the sum of the current net interest expense for year 2 (\$50) plus the interest expense carried over from year 1 (\$20), does not exceed one-half of adjusted taxable income in year 2.

As another example, assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and \$50 of current net and gross interest expense, all of which is disqualified interest, and that it earns \$80 of adjusted taxable income. The bill is intended to clarify that the \$20 of interest carried forward from year 1 is not deductible in year 2. This is because the current net interest expense for year 2 (\$50) exceeds by \$10 one-half of adjusted taxable income in year 2 (\$80 divided by 2, or \$40). Therefore, treating the year 1 carryover as an interest expense in year 2 causes the corporation to have excess interest expense equal to \$30. But for the debt-equity safe harbor, the corporation would have a \$30 interest expense disallowance in year 2 if the carried over amount were treated as having been paid in year 2. Under the bill, no actual year 2 interest can be disallowed. However, under these facts, none of the interest carried over from year 1 can be deducted in year 2. Instead, the interest carried over from year 1 is carried forward for potential deduction (subject to the same rules that applied to the carryforward in year 2) in a year subsequent to year 2.

As a third example, assume that in year 2 the corporation has a debt-equity ratio of 1 to 1 and \$50 of current net and gross interest expense, all of which is disqualified interest, and that it earns

\$110 of adjusted taxable income. The bill is intended to clarify that \$5 of interest carried forward from year 1 is deductible in year 2, and the other \$15 of interest carried forward from year 1 is not deductible in year 2. This is because the current net interest expense for year 2 (\$50) is \$5 less than one-half of adjusted taxable income in year 2 (one-half of \$110, or \$55). Therefore, even if the debt-equity safe harbor had not been met in year 2, the corporation would have had \$5 of excess limitation in year 2 had there been no carry-over amount from year 1. On the other hand, treating the year 1 carryover as an interest expense in year 2 causes the corporation to have excess interest expense equal to \$15. This \$15 may be carried forward to a subsequent year.

The provision is effective as if included in the amendments made by section 7210(a) of the Revenue Reconciliation Act of 1989.

**7. Interaction between passive activity loss rules and earnings stripping rules (secs. 1704(f)(2) (B) and (C) of the bill, sec. 7210(a) of the 1989 Act, and sec. 163(j) of the Code)**

***Present Law***

The passive loss rules limit deductions and credits from passive trade or business activities (sec. 469). Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income, such as wages, portfolio income, or business income that is not derived from a passive activity. Deductions and credits that are suspended are carried forward and treated as deductions and credits from passive activities in the next year. Suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person. The passive loss rules apply to any taxpayer that is an individual, estate, trust, closely held C corporation, or personal service corporation. In determining passive activity deductions, Treasury regulations provide that “an item of deduction arises in the taxable year in which the item would be allowable as a deduction under the taxpayer’s method of accounting if taxable income for all taxable years were determined without regard to sections 469, 613A(d) and 1211” (Treas. Reg. sec. 1.469–2(d)(8)). Thus, these regulations effectively require other limitations to be applied before applying the passive loss rules.

The at-risk rules limit deductible losses from an activity to the amount that the taxpayer has at risk, in the case of an individual or a closely-held corporation (sec. 465). The amount at risk is generally the sum of (1) cash contributions, (2) the adjusted basis of contributed property, and (3) amounts borrowed for use in the activity with respect to which the taxpayer has personal liability or has pledged as security property not used in the activity. The amount at risk is increased by income from the activity and decreased by losses and withdrawals.

A taxpayer generally may deduct interest paid or accrued on indebtedness within a taxable year (sec. 163(a)). The Revenue Reconciliation Act of 1989 (the “1989 Act”) added an “earnings stripping” limitation on interest deductibility with respect to certain in-

terest paid by corporations to related persons (sec. 163(j)). If the provision applies to a corporation for a taxable year, it disallows deductions for certain amounts of “disqualified interest” paid or accrued by the corporation during that year. Disqualified interest is interest paid by a corporation to related persons that are not subject to U.S. tax on the interest received. The disallowed amount is treated under the earnings stripping provision as disqualified interest paid or accrued in the succeeding taxable year. Proposed Treasury regulations would provide that “sections 465 and 469 shall be applied before applying section 163(j)” (Prop. Treas. Reg. sec. 1.163(j)-7(b)(3)).

### ***Explanation of Provision***

The provision modifies section 163(j) of the Code to clarify that the earnings stripping rules apply before the passive loss rules and the at-risk rules.

The provision is effective as if included in the 1989 Act.

## **8. Branch-level interest tax (sec. 1704(f)(3) of the bill, sec. 1241 of the 1986 Act, and sec. 884 of the Code)**

### ***Present Law***

Interest paid (or treated as if paid) by a U.S. trade or business (i.e., a U.S. branch) of a foreign corporation is treated as if paid by a U.S. corporation and, hence, is U.S. source and subject to U.S. withholding tax of 30 percent, unless the tax is reduced or eliminated by a specific Code or treaty provision. The Treasury has regulatory authority to limit U.S. sourcing, and hence U.S. withholding, to the amount of interest reasonably expected to be deducted in arriving at the U.S. branch’s effectively connected taxable income.

To the extent a U.S. branch of a foreign corporation has allocated to it under Treasury Regulation section 1.882-5 an interest deduction in excess of the interest actually paid by the branch (this generally occurs where the indebtedness of the U.S. branch is disproportionately small compared to the total indebtedness of the foreign corporation), the excess is treated as if it were interest paid on a notional loan to a U.S. subsidiary (the U.S. branch, in actuality) from its foreign corporate parent (the home office). This excess is subject to the 30-percent tax, absent a specific Code exemption or treaty reduction (sec. 884(f)(1)(B)).

These branch-level interest taxes, along with the branch profits tax, were intended to reflect the view that a foreign corporation doing business in the United States generally should be subject to the same substantive tax rules that apply to a foreign corporation operating in the United States through a U.S. subsidiary.<sup>39</sup> Where a U.S. corporation pays interest to its foreign corporate parent, that interest, like the interest deducted by a U.S. branch of a foreign corporation, is also generally subject to a 30-percent U.S. withholding tax unless the tax is reduced by treaty. In the case of a U.S. subsidiary of a foreign parent corporation, the withholding tax

<sup>39</sup>Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess. *General Explanation of the Tax Reform Act of 1986*, at 1036 (1987).

applies without regard to whether the interest payment is currently deductible by the U.S. subsidiary. For example, deductions for interest may be delayed or denied under section 163, 263, 263A, 266, 267, or 469, but it is still subject (or not subject) to withholding when paid without regard to the operation of those provisions.

### ***Explanation of Provision***

The bill provides that the branch level interest tax on interest not actually paid by the branch applies to any interest which is allocable to income which is effectively connected with the conduct of a trade or business in the United States. Similarly, in the case of interest paid by the U.S. branch, the bill provides regulatory authority to limit U.S. sourcing, and hence U.S. withholding, to the amount of interest reasonably expected to be allocable to income which is effectively connected with the conduct of a trade or business in the United States. Thus, where an interest expense of a foreign corporation is allocable to U.S. effectively connected income, but that interest expense would not have been fully deductible for tax purposes under another Code provision had it been paid by a U.S. corporation, the bill clarifies that such interest is nonetheless treated for branch level interest tax purposes like a payment by a U.S. corporation to a foreign corporate parent. Similarly, with regard to the Treasury's regulatory authority to treat an interest payment by a foreign corporation's U.S. branch as though not paid by a U.S. person for source and withholding purposes, the bill clarifies that the authority extends to interest payments in excess of those reasonably expected to be allocable to U.S. effectively connected income of the foreign corporation.

These provisions are effective as if they were made by the Tax Reform Act of 1986.

### **9. Determination of source in case of sales of inventory property (sec. 1704(f)(4) of the bill, sec. 211 of the 1986 Act, and sec. 865(b) of the Code)**

#### ***Present Law***

Prior to the 1986 Act, the source of income derived from the sale of personal property generally was determined by the place of sale (commonly referred to as the "title passage" rule) (see, e.g., Treas. Reg. sec. 1.861-7, T.D. 6258, 1957-2 C.B. 368). While the 1986 Act generally replaced the place-of-sale rule for sales of personal property with a residence-of-the-seller rule (sec. 865(a)), the Act did not change the place-of-sale rule for most sales of inventory property (sec. 865(b)).

Before and after the 1986 Act, statutory rules for sourcing income from inventory sales have included those covering income from (1) purchasing inventory property outside the United States (other than within a U.S. possession) and selling it in the United States (sec. 861(a)(6)); (2) purchasing inventory property in the United States and selling it outside the United States (sec. 862(a)(6)); (3) selling outside the United States inventory property which has been produced by the taxpayer in the United States (or selling in the United States inventory property which has been produced by the taxpayer outside the United States) (sec. 863(b)(2));



and (4) purchasing inventory property in a U.S. possession and selling it in the United States (sec. 863(b)(3)). Prior to the 1986 Act, these provisions were not limited in application to income from sales of inventory property, but rather covered sales of personal property generally.

In addition to statutory rules for sourcing items of income from transactions involving inventory property specified in the Code, such as those listed above, the Code both before and after the 1986 Act has contained other sourcing rules that do not make specific reference to property sales, and includes general regulatory authority to allocate and apportion between U.S. and foreign sources items of gross income, expenses, losses, and deductions other than those specified in sections 861(a) and 862(a) (sec. 863(a)). In carving income from the sale inventory property out of the general residence-of-the-seller rule of section 865, section 865(b) makes reference to the above statutory rules making specific reference to inventory property, but not to the general grant of regulatory authority in section 863(a).

#### ***Explanation of Provision***

The bill modifies the general provision relating to the sourcing of income from the sale of personal property (sec. 865) so that the cross-reference to sourcing rules applicable to inventory property includes a reference to all of section 863, rather than simply to section 863(b). The bill thus clarifies that, to the extent that the Secretary of the Treasury had general regulatory authority to provide rules for the sourcing of income from the sales of personal property prior to the 1986 Act, the Secretary of the Treasury retains that authority under present law with respect to inventory property.

The bill is not intended to increase the Treasury Secretary's regulatory authority under section 863(a) beyond the authority that he had under the law in effect prior to the enactment of the 1986 Act. It is intended that no inference be drawn from this provision either as to the correctness of, or as to the post-1986 Act implications of, any judicial decision interpreting the scope of that pre-1986 Act authority.

The provision is effective as if it were included in the Tax Reform Act of 1986.

#### **10. Repeal of obsolete provisions (sec. 1704(f)(5) of the bill, sec. 10202 of the Revenue Act of 1987, and secs. 6038(a)(1)(F) and 6038A(b)(4) of the Code)**

##### ***Present Law***

A U.S. person who controls a foreign corporation must report certain information related to that foreign corporation as may be required by the Treasury Secretary (sec. 6038). Information reporting is also required with respect to certain foreign-owned domestic corporations (sec. 6038A). Included under each of these information reporting provisions is a requirement to report such information as the Treasury Secretary may require for purposes of carrying out the provisions of section 453C. Section 453C, relating to certain indebtedness treated as payment on installment obligations (the so-

called “proportional disallowance rule”), was repealed in the Revenue Act of 1987.

***Explanation of Provision***

The bill repeals as obsolete the information reporting requirements of sections 6038 and 6038A relating to section 453C. The provision is effective upon the date of its enactment.

**11. Clarification of a certain stadium bond transition rule in Tax Reform Act of 1986 (sec. 1704(g) of the bill and sec. 1317(3)(A) of the Tax Reform Act of 1986)**

***Present Law***

The Tax Reform Act of 1986 included a transition rule authorizing tax-exempt bonds not exceeding \$200 million to be issued by or on behalf of the City of Cleveland, Ohio, to finance a stadium. The bonds were required to be issued before January 1, 1991 (and were so issued). As enacted, the rule required Cleveland to retain a residual interest in the stadium following planned private business use.

***Explanation of Provision***

The bill permits the residual interest in the stadium currently held by the City of Cleveland to be assigned to Cuyahoga County, Ohio (the county in which both Cleveland and the stadium are located) because of a change in Ohio State law prior to issuance of the bonds. The bill does not extend the time for issuing the bonds or otherwise affect the amount of bonds or the location or design of the stadium.

This provision is effective as if included in the Tax Reform Act of 1986.

**12. Health care continuation rules (sec. 1704(h) of the bill, sec. 7862(c)(5) of the 1989 Act, sec. 4980B(f)(2)(B)(i) of the Code, sec. 602(2)(A) of ERISA, and sec. 2202(2)(A) of the Public Health Service Act)**

***Present Law***

The Revenue Reconciliation Act of 1989 (“1989 Act”) amended the health care continuation rules to provide that if a covered employee is entitled to Medicare and within 18 months of such entitlement separates from service or has a reduction in hours, the duration of continuation coverage for the spouse and dependents is 36 months from the date the covered employee became entitled to Medicare. One possible interpretation of the statutory language, however, would permit continuation coverage for up to 54 months. This extension of the coverage period was not intended.

***Explanation of Provision***

The bill amends the Code (sec. 4980B), title I of the Employee Retirement Income Security Act (sec. 602), and the Public Health Service Act (sec. 2202(2)(A)) to limit the continuation coverage in

such cases to no more than 36 months. The provision is effective for plan years beginning after December 31, 1989.

**13. Taxation of excess inclusions of a residual interest in a REMIC for taxpayers subject to alternative minimum tax with net operating losses (sec. 1704(i) of the bill and sec. 860E(a)(6) of the Code)**

***Present Law***

***Residual interests in a REMIC***

A real estate mortgage investment conduit ("REMIC") is an entity that holds real estate mortgages. All interests in a REMIC must be "regular interests" or "residual interests." A regular interest is an interest the terms of which are fixed on the start-up day, which unconditionally entitles the holder to receive a specified principal amount, and which provides that interest amounts are payable based on a fixed rate (or a variable rate to the extent provided in the Treasury regulations). A residual interest is any interest that is so designated and that is not a regular interest in a REMIC.

Generally, the holder of a residual interest in a REMIC takes into account his daily portion of the taxable income or net loss of such REMIC for each day during which he held such interest. The taxable income of any holder of a residual interest in a REMIC for any taxable year cannot be less than the excess inclusion for the year (sec. 860E). Thus, in general, income from excess inclusions cannot be offset by a net operating loss (or net operating loss carryover) in computing the taxpayer's regular tax.

***Alternative minimum tax***

Taxpayers are subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent it exceeds the taxpayer's regular tax. The tax is imposed at rates of 26 and 28 percent (20 percent in the case of a corporation) on alternative minimum taxable income in excess of an exemption amount. Alternative minimum taxable income generally is the taxpayer's taxable income, as increased or decreased by certain adjustments and preferences. A taxpayer may offset no more than ninety percent of its alternative minimum taxable income with its alternative tax net operating loss carryover.

Because the determination of a taxpayer's alternative minimum taxable income begins with taxable income, a holder of a residual interest in a REMIC may have positive alternative minimum taxable income even where the taxpayer has a net operating loss for the year.

***Explanation of Provision***

The bill provides that three rules for determining the alternative minimum taxable income of a taxpayer that is not a thrift institution that holds residual interests in a REMIC.

First, the alternative minimum taxable income of such a taxpayer is computed without regard to the REMIC rule that taxable

income cannot be less than the amount of excess inclusions. This provision prevents a taxpayer from having to include in alternative minimum taxable income preference items for which it received no tax benefit.

Second, the alternative minimum taxable income of such a taxpayer for a taxable year cannot be less than the excess inclusions of the residual interests for that year. In effect, this provision prevents nonrefundable credits from reducing the taxpayer's income tax below an amount equal to what the tentative minimum tax would be if computed only on excess inclusions.

Third, the amount of any alternative minimum tax net operating loss deduction of such a taxpayer is computed without regard to any excess inclusions. This provision insures that the net operating losses will not reduce any income attributable to any excess inclusions. Thus, all such taxpayers subject to the alternative minimum tax will pay a tax on excess inclusions at the alternative minimum tax rate, regardless of whether the taxpayer has a net operating loss.

The provision is effective for all taxable years beginning after December 31, 1986, unless the taxpayer elects to apply the rules of the bill only to taxable years beginning after the date of enactment.

**14. Application of harbor maintenance tax to Alaska and Hawaii ship passengers (sec. 1704(j) of the bill and sec. 4462(b) of the Code)**

***Present Law***

A harbor maintenance excise tax ("harbor tax") of 0.125 percent of value applies generally to commercial cargo (including passenger fares) loaded or unloaded at U.S. ports (sec. 4461). The harbor tax does not apply to commercial cargo (other than crude oil with respect to Alaska) loaded or unloaded in Alaska, Hawaii, and U.S. possessions where such cargo is transported to or from the U.S. mainland (for domestic use) or where such cargo is loaded and unloaded in the same State (Alaska or Hawaii) or possession (sec. 4462(b)).

***Explanation of Provision***

The bill clarifies that the harbor tax does not apply to passenger fares where the passengers are transported on U.S. flag vessels operating solely within the State waters of Alaska or Hawaii and adjacent international waters (i.e., leaving and returning to a port in the same State without stopping elsewhere).

The provision applies as if included in the Harbor Maintenance Revenue Act of 1986 (April 1, 1987).

**15. Modify effective date provision relating to the Energy Policy Act of 1992 (sec. 1704(k) of the bill and secs. 53 and 30 of the Code)**

***Present Law***

The nonconventional fuels production credit (sec. 29) cannot reduce the taxpayer's tax liability to less than the amount of the tentative minimum tax. The credit for prior year minimum tax liabil-

ity (sec. 53) is increased by the amount of the nonconventional fuels credit not allowed for the taxable year solely by reason of the limitation based on the taxpayer's tentative minimum tax.

### ***Explanation of Provision***

The bill corrects a cross reference to section 29(b)(6)(B) contained in section 53(d)(1)(B)(iv), and clarifies that the correction applies to taxable years beginning after December 31, 1990. In addition, section 2(e)(5) of the bill clarifies that a correction made in the Energy Policy Act of 1992 to a similar cross reference in section 53(d)(1)(B)(iii) applies to taxable years beginning after December 31, 1990.

The bill also clarifies the relationship between the basis adjustment rules for the electric vehicle credit (sec. 30(d)(1)) and the alternative minimum tax.

### **16. Treat qualified football coaches plan as multiemployer pension plan for purposes of the Internal Revenue Code (sec. 1704(l) of the bill and sec. 1022 of ERISA)**

#### ***Present Law***

Section 3(37) of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended by Public Law 100-202 (Continuing Appropriations for Fiscal Year 1988), provides that, for purposes of Title I of ERISA, a qualified football coaches plan generally is treated as a multiemployer plan and may include a qualified cash or deferred arrangement. Under section 3(37) of ERISA, a qualified football coaches plan is defined as any defined contribution plan established and maintained by an organization described in section 501(c) of the Internal Revenue Code (the "Code"), the membership of which consists entirely of individuals who primarily coach football as full-time employees of 4-year colleges or universities, if the organization was in existence on September 18, 1986. This definition is generally intended to apply to the American Football Coaches Association.

However, section 9343(a) of the Omnibus Budget Reconciliation Act of 1987 (P.L. 100-203) provides that Titles I and IV of ERISA are not applicable in interpreting Title II of ERISA (the Code provisions relating to qualified plans), except to the extent specifically provided in the Code or as determined by the Secretary of the Treasury.

### ***Explanation of Provision***

The bill amends Title II of ERISA to provide that, for purposes of determining the qualified plan status of a qualified football coaches plan, section 3(37) of ERISA is treated as part of Title II of ERISA and a qualified football coaches plan is treated as a multiemployer collectively bargained plan.

The provision is effective for years beginning after December 22, 1987 (the date of enactment of P.L. 100-202).

**17. Determination of unrecovered investment in annuity contract (sec. 1704(m) of the bill and sec. 72(b) and (c) of the Code)**

***Present Law***

An exclusion is provided for amounts received as an annuity under an annuity, endowment, or life insurance contract, as determined under a statutory exclusion ratio (sec. 72(b)). The exclusion ratio is determined as the ratio of (1) the taxpayer's investment in the contract (as of the annuity starting date) to (2) the expected return under the contract (as of such date). In the case of a contract with a refund feature, the amount of a taxpayer's investment in the contract is reduced by the value of the refund feature (sec. 72(c)).

This exclusion was modified by the Tax Reform Act of 1986 to limit the excludable amount to the taxpayer's unrecovered investment in the contract, and to provide a deduction for the unrecovered investment in the contract if payments as an annuity under the contract cease by reason of the death of an annuitant. In the case of a contract with a refund feature, the 1986 Act modifications reduce the exclusion ratio so that it is possible that less than the entire investment in the contract can be recovered tax-free.

***Explanation of Provision***

The bill modifies the definition of the unrecovered investment in the contract, in the case of a contract with a refund feature, so that the entire investment in the contract can be recovered tax-free.

The provision is effective as if enacted in the Tax Reform Act of 1986.

**18. Election by parent to claim unearned income of certain children on parent's return (sec. 1704(n) of the bill and secs. 1 and 59(j) of the Code)**

***Present Law***

The net unearned income of a child under 14 years of age is taxed to the child at the parent's statutory rate. Net unearned income means unearned income less the sum of \$650 (for 1995) and the greater of: (1) \$650 (for 1995) or, (2) if the child itemizes deductions, the amount of allowable deductions directly connected with the production of the unearned income. The dollar amounts are adjusted for inflation.

In certain circumstances, a parent may elect to include a child's unearned income on the parent's income tax return if the child's income is less than \$5,000. A parent making this election must include the gross income of the child in excess of \$1,000 in income for the taxable year. In addition, the parent must report an additional tax liability equal to the lesser of (1) \$75 or (2) 15 percent of the excess of the child's income over \$500. The dollar amounts for the election are not adjusted for inflation.

A person claimed as a dependent cannot claim a standard deduction exceeding the greater of \$650 (for 1995) or such person's earned income. For alternative minimum tax purposes, the exemp-

tion of a child under 14 years of age generally cannot exceed the sum of such child's earned income plus \$1,000. The \$650 amount is adjusted for inflation but the \$1,000 amount is not.

### ***Explanation of Provision***

The bill adjusts for inflation the dollar amounts involved in the election to claim unearned income on the parent's return. It likewise indexes the \$1,000 amount used in computing the child's alternative minimum tax.

The provision is effective for taxable years beginning after December 31, 1995.

### **19. Treatment of certain veterans' reemployment rights (sec. 1704(o) of the bill and new sec. 414(u) of the Code)**

#### ***Present Law***

Under the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA"), Pub. L. No. 103-353, 38 U.S.C. §§4301, ff., which revised and restated the Federal law protecting veterans' reemployment rights, an employee who leaves a civilian job for qualified military service generally is entitled to be reemployed by the civilian employer if the individual returns to employment within a specified time period. In addition to reemployment rights, a returning veteran also is entitled to the restoration of certain pension, profit sharing and similar benefits that would have accrued, but for the employee's absence due to the qualified military service.

USERRA generally provides that for a reemployed veteran service in the uniformed services is considered service with the employer for retirement plan benefit accrual purposes, and the employer that reemploys the returning veteran is liable for funding any resulting obligation. USERRA also provides that the reemployed veteran is entitled to any accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals only to the extent the reemployed veteran makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the reemployed veteran would have been permitted or required to contribute had the person remained continuously employed by the employer throughout the period of uniformed service. Under USERRA, any such payment to the plan must be made during the period beginning with the date of reemployment and whose duration is three times the reemployed veteran's period of uniform service, not to exceed five years.

Under the Internal Revenue Code, overall limits are provided on contributions and benefits under certain retirement plans. For example, the maximum amount of elective deferrals that can be made by an individual into a qualified cash or deferred arrangement in any taxable year is limited to \$9,500 for 1996 (sec. 402(g)). Annual additions with respect to each participant under a qualified defined contribution plan generally are limited to the lesser of \$30,000 (for 1996) or 25 percent of compensation (sec. 415(c)). Annual deferrals with respect to each participant under an eligible deferred compensation plan (sec. 457) generally are limited to the lesser of

\$7,500 or 33⅓ percent of includible compensation. There is no provision under present law that permits contributions or deferrals to exceed these and other annual limits in the case of contributions with respect to a reemployed veteran.

Other requirements for which there is no special provision for contributions with respect to a reemployed veteran include the limit on deductible contributions and the qualified plan nondiscrimination, coverage, minimum participation, and top heavy rules.

### ***Explanation of Provision***

The bill provides special rules in the case of certain contributions (“make-up contributions”) with respect to a reemployed veteran that are required or authorized under USERRA. The bill applies to contributions made by an employer or employee to an individual account plan or to contributions made by an employee to a defined benefit plan that provides for employee contributions.

Under the bill, if any make-up contribution is made by an employer or employee with respect to a reemployed veteran, then such contributions are not subject to the generally applicable plan contributions limits (i.e., secs. 402(g), 402(h), 403(b), 408, 415, or 457) or the limit on deductible contributions (i.e., secs. 404(a) or 404(h)) as applied with respect to the year in which the contribution is made. In addition, the make-up contribution are not taken into account in applying the plan contribution or deductible contribution limits to any other contribution made during the year. However, the amount of any make-up contribution could not exceed the aggregate amount of contributions that would have been permitted under the plan contribution and deductible contribution limits for the year to which the contribution relates had the individual continued to be employed by the employer during the period of uniformed service.

Under the bill, a plan to which a make-up contribution is made on account of a reemployed veteran is not treated as failing to meet the qualified plan nondiscrimination, coverage, minimum participation, and top heavy rules (i.e., secs. 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 401(m), 403(b)(12), 408(k)(3), 408(k)(6), 408(p), 410(b), or 416) by reason of the making of such contribution. Consequently, for purposes of applying the requirements and tests associated with these rules, make-up contributions are not taken into account either for the year in which they are made or for the year to which they relate.

Under the bill, a special rule applies in the case of make-up contributions of salary reduction, employer matching, and after-tax employee amounts. A plan that provides for elective deferrals or employee contributions is treated as meeting the requirements of USERRA if the employer permits reemployed veterans to make additional elective deferrals or employee contributions under the plan during the period which begins on the date of reemployment and has the same length as the lesser of (1) the period of the individual’s absence due to uniformed service multiplied by three or (2) five years.

The employer is required to match any additional elective deferrals or employee contributions at the same rate that would have



been required had the deferrals or contributions actually been made during the period of uniformed service. Additional elective deferrals, employer matching contributions, and employee contributions is treated as make-up contributions for purposes of the rule exempting such contributions from qualified plan nondiscrimination, coverage, minimum participation, and top heavy rules as described above.

The bill clarifies that USERRA does not require (1) any earnings to be credited to an employee with respect to any contribution before such contribution is actually made or (2) any make-up allocation of any forfeiture that occurred during the period of uniformed service.

The bill also provides that the plan loan, plan qualification, and prohibited transaction rules will not be violated merely because a plan suspends the repayment of a plan loan during a period of uniformed service.

The bill also defines compensation to be used for purposes of determining make-up contributions and would conform the rules contained in the Code with certain rights of reemployed veterans contained in USERRA pertaining to employee benefit plans.

The provision is effective as of December 12, 1994, the effective date of the benefits-related provisions of USERRA.

**20. Reporting of real estate transactions (sec. 1704(p) of the bill and sec. 6045(e)(3) of the Code)**

***Present Law***

It is unlawful for any real estate reporting person to charge separately any customer for complying with the information reporting requirements with respect to real estate transactions.

***Explanation of Provision***

The bill clarifies that real estate reporting persons may take into account the cost of complying with the reporting requirements of Code section 6045 in establishing charges for their services, so long as a separately listed charge for such costs is not made.

The provision is effective on November 11, 1988 (as if originally enacted as part of the amendment to the Code relating to separate charges).

**21. Clarification of denial of deductions for stock redemption expenses (sec. 1704(q) of the bill and sec. 162(k)(2) of the Code)**

***Present Law***

Section 162(k), added by the Tax Reform Act of 1986, denies a deduction for any amount paid or incurred by a corporation in connection with the redemption of its stock. An exception is provided for any deduction allowable under section 163 (relating to interest). The Internal Revenue Service has taken the position that costs properly allocable to a borrowing the interest on which is deductible under the exception may not be amortized over the period of

the loan, due to section 162(k). Different courts have reached differing conclusions when taxpayers have litigated the question.<sup>40</sup>

### ***Explanation of Provision***

The bill clarifies that amounts properly allocable to indebtedness on which interest is deductible and properly amortized over the term of that indebtedness are not subject to the provision of section 162(k) denying a deduction for any amount paid or incurred by a corporation in connection with the redemption of its stock.

In addition, the bill clarifies that the rules of section 162(k) apply to any acquisition of its stock by a corporation or by a party that has a relationship to the corporation described in section 465(b)(3)(C) (which applies a more than 10 percent relationship test in certain cases).

Thus, for example, it is clarified that the denial of a deduction applies to any reacquisition (i.e., any transaction that is in effect an acquisition of previously outstanding stock) regardless of whether the transaction is treated as a redemption for purposes of subchapter C of the Code, regardless of whether it is treated for tax purposes as a sale of the stock or as a dividend, and regardless of whether the transaction is a reorganization or other transaction.

Apart from the clarification relating to amounts properly allocable to indebtedness, it is not intended that application of the 1986 Act deduction denial to any amount or transaction be limited under the bill.

The provision clarifying that amounts properly allocable to indebtedness and amortized over the term of that indebtedness are not subject to the denial under section 162(k), is effective as if included in the Tax Reform Act of 1986.

The other clarifications apply to amounts paid or incurred after September 13, 1995. No inference is intended that any amounts described in these other clarifications are deductible under present law.

## **22. Definition of passive income in determining passive foreign investment company status (sec. 1704(s) of the bill, sec. 1235 of the 1986 Act and sec. 1296(b)(2) of the Code)**

### ***Present Law***

Under the export trade corporation (ETC) provisions, a controlled foreign corporation (CFC) that qualifies as an ETC is not subject to current U.S. tax on certain export trade income. In 1971, the ETC provisions were replaced by rules applicable to domestic international sales corporations (DISCs). Only those ETCs in existence at that time are allowed to continue operating as ETCs. In 1984, the DISC provisions were largely replaced by the rules applicable to foreign sales corporations (FSCs). Certain foreign trade income of a FSC is exempt from U.S. income tax. In addition, a domestic corporation is allowed a 100-percent dividends-received deduction for dividends distributed from the FSC out of earnings attributable to certain foreign trade income.

<sup>40</sup>See e.g., *Fort Howard Corp. v. Commissioner*, 103 T.C. 345 (1994)(upholding the IRS position); compare *U.S. v. Kroy (Europe) Limited*, 27 F.3d 367 (9th Cir. 1994)(to the contrary).

The Tax Reform Act of 1986 established an anti-deferral regime for passive foreign investment companies (PFICs). A foreign corporation is a PFIC if (1) 75 percent or more of its gross income for the taxable year consists of passive income, or (2) 50 percent or more of the average amount of its assets consists of assets that produce, or are held for the production of passive income. Passive income for this purpose generally means income that satisfies the definition of foreign personal holding company income under subpart F. Foreign personal holding company income generally includes interest, dividends, and annuities; certain rents and royalties; related party factoring income; net commodities gains; net foreign currency gains; and net gains from sales or exchanges of certain other property. In determining whether a foreign corporation is a PFIC, passive income does not include certain active-business banking, insurance, or (in the case of the U.S. shareholders of a CFC) securities income, or certain amounts received from a related party (to the extent that the amounts are allocable to income of the related party which is not passive income).

#### ***Explanation of Provision***

The bill clarifies that foreign trade income of a FSC and export trade income of an ETC do not constitute passive income for purposes of the PFIC definition.

The provision is effective as if it were included in the Tax Reform Act of 1986.

### **23. Exclusion from income for combat zone compensation (sec. 1704(t)(4) of the bill and sec. 112 of the Code)**

#### ***Present Law***

The Code provides that gross income does not include compensation received by a taxpayer for active service in the Armed Forces of the United States for any month during any part of which the taxpayer served in a combat zone (or was hospitalized as a result of injuries, wounds or disease incurred while serving in a combat zone) (limited to \$500 per month for commissioned officers). The heading refers to “combat pay,” although that term is no longer used to refer to special pay provisions for members of the Armed Forces, nor is the exclusion limited to those special pay provisions (hazardous duty pay (37 U.S.C. sec. 301) and hostile fire or imminent danger pay (37 U.S.C. sec. 310)).

#### ***Explanation of Provision***

The bill modifies the heading of Code section 112 to refer to “combat zone compensation” instead of “combat pay.” The bill also makes conforming changes to cross-references elsewhere in the Code. This provision is effective on the date of enactment.

## 24. Certain property not treated as section 179 property (sec. 1704(u) of the bill and sec. 179 of the Code)

### *Present Law*

Section 179 allows a qualified taxpayer (generally, a small business) to elect to expense and deduct, rather than capitalize and depreciate, a limited amount of the cost of property placed in service in the taxpayer's trade or business.

One of the "deadwood provisions" of the Omnibus Budget Reconciliation Act of 1990 ("1990 Act") inadvertently expanded the scope of section 179 to include property described in section 50(b), air conditioning or heating units, and horses. According to legislative history, these 1990 Act provisions were "an attempt to simplify the Code by deleting 'deadwood,' without making substantive changes in the tax law."

### *Explanation of Provision*

The bill restores pre-1990 law to deny the expensing allowance for the following property placed in service after May 14, 1996: (1) property described in section 50(b) (generally, property used outside the U.S., property used in connection with furnishing lodging, property used by tax-exempt organizations, and property used by governments and foreign persons); (2) air conditioning or heating units; and (3) horses.

## III. VOTES OF THE COMMITTEE

In compliance with clause 2(1)(2)(B) of rule XI of the Rules of the House of Representatives, the following statement is made concerning the roll call votes of the Committee in its consideration of the bill.

### *Motion to report the bill*

The bill, H.R. 3448, as amended, was ordered favorably reported on May 14, 1996, by a roll call vote of 33 yeas and 3 nays, with a quorum present. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....	X	.....	.....	Mr. Gibbons .....	X	.....	.....
Mr. Crane .....	X	.....	.....	Mr. Rangel .....	.....	X	.....
Mr. Thomas .....	X	.....	.....	Mr. Stark .....	.....	X	.....
Mr. Shaw .....	X	.....	.....	Mr. Jacobs .....	X	.....	.....
Mrs. Johnson .....	X	.....	.....	Mr. Ford .....	X	.....	.....
Mr. Bunning .....	X	.....	.....	Mr. Matsui .....	.....	X	.....
Mr. Houghton .....	X	.....	.....	Mrs. Kennelly .....	X	.....	.....
Mr. Herger .....	X	.....	.....	Mr. Coyne .....	X	.....	.....
Mr. McCrery .....	X	.....	.....	Mr. Levin .....	X	.....	.....
Mr. Hancock .....	X	.....	.....	Mr. Cardin .....	X	.....	.....
Mr. Camp .....	X	.....	.....	Mr. McDermott .....	X	.....	.....
Mr. Ramstad .....	X	.....	.....	Mr. Kleczka .....	X	.....	.....
Mr. Zimmer .....	.....	.....	.....	Mr. Lewis .....	X	.....	.....
Mr. Nussle .....	X	.....	.....	Mr. Payne .....	X	.....	.....
Mr. Johnson .....	X	.....	.....	Mr. Neal .....	X	.....	.....
Ms. Dunn .....	X	.....	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....	X	.....	.....				
Mr. Portman .....	X	.....	.....				
Mr. Hayes .....	.....	.....	.....				
Mr. Laughlin .....	.....	.....	.....				

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. English .....	X						
Mr. Ensign .....	X						
Mr. Christensen .....	X						

### ***Votes on amendments***

An amendment by Messrs. Levin and Ramstad to the Archer amendment in the nature of a substitute to strike section 1602, which would repeal the exclusion for interest on loans used to acquire employer securities, and add in subtitle F of Title I provisions regarding foreign trust tax compliance, was defeated by a roll call vote of 14 yeas to 17 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X		Mr. Gibbons .....			
Mr. Crane .....		X		Mr. Rangel .....	X		
Mr. Thomas .....		X		Mr. Stark .....	X		
Mr. Shaw .....		X		Mr. Jacobs .....			
Mrs. Johnson .....		X		Mr. Ford .....			
Mr. Bunning .....		X		Mr. Matsui .....	X		
Mr. Houghton .....				Mrs. Kennelly .....	X		
Mr. Herger .....		X		Mr. Coyne .....	X		
Mr. McCrery .....		X		Mr. Levin .....	X		
Mr. Hancock .....		X		Mr. Cardin .....	X		
Mr. Camp .....		X		Mr. McDermott .....	X		
Mr. Ramstad .....	X			Mr. Kleczka .....	X		
Mr. Zimmer .....				Mr. Lewis .....			
Mr. Nussle .....		X		Mr. Payne .....	X		
Mr. Johnson .....	X			Mr. Neal .....	X		
Ms. Dunn .....		X		Mr. McNulty .....	X		
Mr. Collins .....		X					
Mr. Portman .....		X					
Mr. Hayes .....							
Mr. Laughlin .....							
Mr. English .....		X					
Mr. Ensign .....		X					
Mr. Christensen .....		X					

An amendment by Mr. Matsui to the Archer amendment in the nature of a substitute to add at the end of Subtitle A of Title I a new section to extend and modify the research credit, and add at the end of Subtitle F a new section on the temporary restoration of airport and airway trust fund taxes, was defeated by a roll call vote of 14 yeas to 19 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X		Mr. Gibbons .....			
Mr. Crane .....		X		Mr. Rangel .....	X		
Mr. Thomas .....		X		Mr. Stark .....		X	
Mr. Shaw .....		X		Mr. Jacobs .....			
Mrs. Johnson .....	X			Mr. Ford .....			
Mr. Bunning .....		X		Mr. Matsui .....	X		
Mr. Houghton .....		X		Mrs. Kennelly .....	X		
Mr. Herger .....		X		Mr. Coyne .....	X		
Mr. McCrery .....		X		Mr. Levin .....	X		
Mr. Hancock .....		X		Mr. Cardin .....	X		
Mr. Camp .....		X		Mr. McDermott .....	X		
Mr. Ramstad .....		X		Mr. Kleczka .....	X		
Mr. Zimmer .....				Mr. Lewis .....	X		
Mr. Nussle .....		X		Mr. Payne .....	X		
Mr. Johnson .....		X		Mr. Neal .....	X		

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Ms. Dunn .....		X	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....		X					
Mr. Portman .....		X					
Mr. Hayes .....							
Mr. Laughlin .....							
Mr. English .....	X	.....					
Mr. Ensign .....		X					
Mr. Christensen .....		X					

An amendment by Mr. McDermott to the Archer amendment in the nature of a substitute to add at the end of Chapter 4 of Subtitle D a new section to provide that distributions from certain plans may be used without penalty during periods of unemployment, and add at the end of Subtitle F of Title I a new section on the temporary restoration of airport and airway trust fund taxes, was defeated by a roll call vote of 14 yeas to 19 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X	.....	Mr. Gibbons .....			.....
Mr. Crane .....		X	.....	Mr. Rangel .....	X		.....
Mr. Thomas .....		X	.....	Mr. Stark .....	X		.....
Mr. Shaw .....		X	.....	Mr. Jacobs .....			.....
Mrs. Johnson .....		X	.....	Mr. Ford .....			.....
Mr. Bunning .....		X	.....	Mr. Matsui .....	X		.....
Mr. Houghton .....		X	.....	Mrs. Kennelly .....	X		.....
Mr. Herger .....		X	.....	Mr. Coyne .....	X		.....
Mr. McCrery .....		X	.....	Mr. Levin .....	X		.....
Mr. Hancock .....		X	.....	Mr. Cardin .....	X		.....
Mr. Camp .....		X	.....	Mr. McDermott .....	X		.....
Mr. Ramstad .....		X	.....	Mr. Kleczka .....	X		.....
Mr. Zimmer .....			.....	Mr. Lewis .....	X		.....
Mr. Nussle .....		X	.....	Mr. Payne .....	X		.....
Mr. Johnson .....		X	.....	Mr. Neal .....	X		.....
Ms. Dunn .....		X	.....	Mr. McNulty .....	X		.....
Mr. Collins .....		X					
Mr. Portman .....		X					
Mr. Hayes .....							
Mr. Laughlin .....							
Mr. English .....	X	.....					
Mr. Ensign .....		X					
Mr. Christensen .....		X					

An amendment by Mr. Neal to the Archer amendment in the nature of a substitute to add at the end of Subtitle A of Title I a new section for the deduction for higher education expenses, and at the end of Subtitle F of Title I a new section on the temporary restoration of airport and airway trust fund taxes, was defeated by a roll call vote of 13 yeas to 20 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X	.....	Mr. Gibbons .....			.....
Mr. Crane .....		X	.....	Mr. Rangel .....	X		.....
Mr. Thomas .....		X	.....	Mr. Stark .....	X		.....
Mr. Shaw .....		X	.....	Mr. Jacobs .....			.....
Mrs. Johnson .....		X	.....	Mr. Ford .....			.....
Mr. Bunning .....		X	.....	Mr. Matsui .....	X		.....
Mr. Houghton .....		X	.....	Mrs. Kennelly .....	X		.....
Mr. Herger .....		X	.....	Mr. Coyne .....	X		.....
Mr. McCrery .....		X	.....	Mr. Levin .....	X		.....
Mr. Hancock .....		X	.....	Mr. Cardin .....	X		.....

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Camp .....		X	.....	Mr. McDermott .....	X	.....	.....
Mr. Ramstad .....		X	.....	Mr. Kleczka .....	X	.....	.....
Mr. Zimmer .....			.....	Mr. Lewis .....	X	.....	.....
Mr. Nussle .....		X	.....	Mr. Payne .....	X	.....	.....
Mr. Johnson .....		X	.....	Mr. Neal .....	X	.....	.....
Ms. Dunn .....		X	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....		X	.....				
Mr. Portman .....		X	.....				
Mr. Hayes .....			.....				
Mr. Laughlin .....			.....				
Mr. English .....		X	.....				
Mr. Ensign .....		X	.....				
Mr. Christensen .....		X	.....				

An amendment by Mr. Levin to the Archer amendment in the nature of a substitute to strike subsections (b) and (c)(2) of section 1202 (relating to limitation to education below graduate level), and insert at the end of Subtitle F a new section on expansion of the requirement that involuntarily converted property be replaced with property acquired from an unrelated person, and a new section on financial asset securitization investment trusts, was agreed to by a roll call vote of 18 yeas to 15 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X	.....	Mr. Gibbons .....		.....	.....
Mr. Crane .....		X	.....	Mr. Rangel .....	X	.....	.....
Mr. Thomas .....		X	.....	Mr. Stark .....	X	.....	.....
Mr. Shaw .....	X	.....	.....	Mr. Jacobs .....	X	.....	.....
Mrs. Johnson .....		X	.....	Mr. Ford .....		.....	.....
Mr. Bunning .....		X	.....	Mr. Matsui .....	X	.....	.....
Mr. Houghton .....	X	.....	.....	Mrs. Kennelly .....	X	.....	.....
Mr. Herger .....		X	.....	Mr. Coyne .....		.....	.....
Mr. McCrery .....		X	.....	Mr. Levin .....	X	.....	.....
Mr. Hancock .....		X	.....	Mr. Cardin .....	X	.....	.....
Mr. Camp .....	X	.....	.....	Mr. McDermott .....	X	.....	.....
Mr. Ramstad .....	X	.....	.....	Mr. Kleczka .....	X	.....	.....
Mr. Zimmer .....			.....	Mr. Lewis .....	X	.....	.....
Mr. Nussle .....		X	.....	Mr. Payne .....	X	.....	.....
Mr. Johnson .....		X	.....	Mr. Neal .....	X	.....	.....
Ms. Dunn .....		X	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....		X	.....				
Mr. Portman .....		X	.....				
Mr. Hayes .....			.....				
Mr. Laughlin .....			.....				
Mr. English .....		X	.....				
Mr. Ensign .....	X	.....	.....				
Mr. Christensen .....		X	.....				

An amendment by Mr. Kleczka to the Archer amendment in the nature of a substitute to strike subsection (a)(2) of section 1112 (relating to the effective date of the employer tax credit for FICA taxes paid on tip income) was defeated by a roll call vote of 13 yeas to 20 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X	.....	Mr. Gibbons .....		.....	.....
Mr. Crane .....		X	.....	Mr. Rangel .....	X	.....	.....
Mr. Thomas .....		X	.....	Mr. Stark .....	X	.....	.....
Mr. Shaw .....		X	.....	Mr. Jacobs .....	X	.....	.....
Mrs. Johnson .....		X	.....	Mr. Ford .....		.....	.....
Mr. Bunning .....		X	.....	Mr. Matsui .....	X	.....	.....

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Houghton .....		X	.....	Mrs. Kennelly .....	X	.....	.....
Mr. Herger .....		X	.....	Mr. Coyne .....	.....	.....	.....
Mr. McCrery .....		X	.....	Mr. Levin .....	X	.....	.....
Mr. Hancock .....		X	.....	Mr. Cardin .....	X	.....	.....
Mr. Camp .....		X	.....	Mr. McDermott .....	X	.....	.....
Mr. Ramstad .....		X	.....	Mr. Kleczka .....	X	.....	.....
Mr. Zimmer .....		.....	.....	Mr. Lewis .....	X	.....	.....
Mr. Nussle .....		X	.....	Mr. Payne .....	X	.....	.....
Mr. Johnson .....		X	.....	Mr. Neal .....	X	.....	.....
Ms. Dunn .....		X	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....		X	.....				
Mr. Portman .....		X	.....				
Mr. Hayes .....		.....	.....				
Mr. Laughlin .....		.....	.....				
Mr. English .....		X	.....				
Mr. Ensign .....		X	.....				
Mr. Christensen .....		X	.....				

Reconsideration of an amendment by Mr. Levin to the Archer amendment in the nature of a substitute to strike subsections (b) and (c)(2) of section 1202 (relating to limitation to education below graduate level), and insert at the end of Subtitle F a new section on expansion of the requirement that involuntarily converted property be replaced with property acquired from an unrelated person, and a new section on financial asset securitization investment trusts, was defeated by a roll call vote of 16 yeas to 20 nays. The vote was as follows:

Representatives	Yea	Nay	Present	Representatives	Yea	Nay	Present
Mr. Archer .....		X	.....	Mr. Gibbons .....	.....	.....	.....
Mr. Crane .....		X	.....	Mr. Rangel .....	X	.....	.....
Mr. Thomas .....		X	.....	Mr. Stark .....	X	.....	.....
Mr. Shaw .....		X	.....	Mr. Jacobs .....	X	.....	.....
Mrs. Johnson .....		X	.....	Mr. Ford .....	X	.....	.....
Mr. Bunning .....		X	.....	Mr. Matsui .....	X	.....	.....
Mr. Houghton .....		X	.....	Mrs. Kennelly .....	X	.....	.....
Mr. Herger .....		X	.....	Mr. Coyne .....	X	.....	.....
Mr. McCrery .....		X	.....	Mr. Levin .....	X	.....	.....
Mr. Hancock .....		X	.....	Mr. Cardin .....	X	.....	.....
Mr. Camp .....		X	.....	Mr. McDermott .....	X	.....	.....
Mr. Ramstad .....		X	.....	Mr. Kleczka .....	X	.....	.....
Mr. Zimmer .....		.....	.....	Mr. Lewis .....	X	.....	.....
Mr. Nussle .....		X	.....	Mr. Payne .....	X	.....	.....
Mr. Johnson .....		X	.....	Mr. Neal .....	X	.....	.....
Ms. Dunn .....		X	.....	Mr. McNulty .....	X	.....	.....
Mr. Collins .....		X	.....				
Mr. Portman .....		X	.....				
Mr. Hayes .....		.....	.....				
Mr. Laughlin .....		.....	.....				
Mr. English .....		X	.....				
Mr. Ensign .....		X	.....				
Mr. Christensen .....		X	.....				



#### **IV. BUDGET EFFECTS OF THE BILL**

##### **A. Committee Estimates of Budgetary Effects**

In compliance with clause 7(a) of rule XIII of the Rules of the House of Representatives, the following statement is made concerning the budget effects of the bill, H.R. 3448, as reported.

The bill is estimated to have the following effects on the budget for fiscal years 1996–2003:

[illegible]

[illegible]

#### IV. Pension Simplification Provisions:

### A. Simplified Distribution Rules:

### 1. Repeal of 5-year income

1. Repeal of 5-year income averaging for lump-sum distributions .....
2. Repeal of \$5,000 exclusion of employees' death benefits .....
3. Simplified method for taxing annuity distributions under certain employer plans .....
4. Minimum required distributions .....

B. Increased Access to Pension Plans:

1. Establish SIMPLE pension plan, but repeal salary reduction SEPs
2. Tax-exempt organization eligible under section 401(k)

C. Nondiscrimination Provisions:

1. Simplified definition of highly compensated employees [8] .....
2. Repeal of family aggregation rules<sup>8</sup> .....
3. Modification of additional participation requirements .....
4. Safe-harbor nondiscrimination rules for qualified cash or deferred arrangements and matching contributions<sup>11</sup> .....
5. Definition of compensation for section 415 purposes .....

#### D. Miscellaneous Provision:

- 1. Plans covering self-employed individuals .....
- 2. Elimination of special vesting rule for multiemployer plans .....
- 3. Distributions under rural cooperative plans .....
- 4. Treatment of governmental plans under section 415 .....
- 5. Uniform retirement age<sup>8</sup> .....

[illegible]

**Estimated Budget Effects of H.R. 3448, the “Small Business Job Protection Act of 1996,” As Approved by the Committee on Ways and Means—Continued**  
[Fiscal Years 1996–2003, in millions of dollars]

Provision	Effective	1996	1997	1998	1999	2000	2001	2002	2003	1996– 2000	1996– 2003
6. Contributions on behalf of disabled employees .....	yba 12/31/96										
7. Treatment of deferred compensation plans of State and local governments and tax-exempt organizations .....	tyba 12/31/96		(1)	–1	–1	–1	–2	–2	–2	–3	–9
8. Require individual ownership of section 457 plan assets .....	DOE		–7	–21	–24	–25	–25	–26	–27	–77	–155
9. Correction of GATT interest and mortality rate provisions in the Retirement Protection Act permanent change .....	eali GATT		–4	–4	–4					–12	–12
10. Multiple salary reduction agreements permitted under section 403(b) .....											
11. Application of elective deferred limit to section 403(b) plans .....	tyba 12/31/95										
12. Treatment of Indian tribal governments under section 403(b) .....	tyba 12/31/95										
13. Repeal of combined plan limit .....	pybb 1/1/95										
14. 3-year waiver of excess distribution tax .....	yba 12/31/98										
15. Increase section 4975 excise tax on prohibited transactions from 5% to 10% .....	1/1/96		49	43	3					–259	–862
16. Modify notice required of right to qualified joint and survivor annuity .....	plaa DOE		2	4	4	4	4	4	4	14	26
17. Treatment of leased employees .....	pyba 12/31/96										
18. Uniform penalty provision to apply to certain pension reporting requirements .....	yba 12/31/96										
19. Clarify that SECA does not apply to certain parsonage allowance income .....	1/1/97										
20. Date of adoption of plan amendments .....	ybb/a 12/31/94										
	DOE										
<b>Subtotal of Pension Simplification Provisions</b> .....			90	47	–74	–344	–368	–408	–438	–281	–1,495
<b>V. Foreign Simplification—Repeal of excess passive assets provision (section 956A)</b> .....	tyba 12/31/96		–11	–22	–29	–36	–41	–45	–51	–98	–235
<b>VI. Revenue Offsets:</b>											
1. Possessions tax credit: Wage credit companies—6 years of present law, followed by 4-year phaseout with modified base period; income companies—2 years of present law followed by 8-year phaseout with modified base period; QPSII—repealed 1/1/96 .....	tyba 12/31/95	255	605	552	596	498	516	746	1,116	2,506	4,884

2. Repeal 50 % interest income exclusion for financial institution loans to ESOPs .....	12	68	108	148	186	223	260	295	521	1,299
3. Apply look-through rule for purposes of characterizing certain sub-part F insurance income as UBTI .....	7	23	24	27	30	32	34	37	111	214
4. Corporate accounting—reform of income forecast method .....	32	69	29	13	14	16	19	22	157	214
5. Modify exclusion of damages received on account of personal injury or sickness .....	5	50	55	59	61	64	68	71	230	433
6. Repeal advance refunds of diesel fuel tax for diesel cars and light trucks .....	3	17	19	19	19	19	19	19	76	133
<b>Subtotal of Revenue Offsets .....</b>	<b>314</b>	<b>832</b>	<b>787</b>	<b>862</b>	<b>808</b>	<b>870</b>	<b>1,146</b>	<b>1,560</b>	<b>3,601</b>	<b>7,177</b>
<b>VII. Technical Corrections—Luxury excise tax, expensing modification, and other technical corrections .....</b>	<b>14</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>(<sup>1</sup>)</b>	<b>13</b>	<b>13</b>
<b>Net Total .....</b>	<b>21</b>	<b>– 143</b>	<b>308</b>	<b>144</b>	<b>– 271</b>	<b>– 240</b>	<b>33</b>	<b>327</b>	<b>56</b>	<b>176</b>

<sup>1</sup> Loss of less than \$500,000.

<sup>2</sup> Credit rate at 35% on first \$6,000 of income; eligible workers expanded to include welfare cash recipients and veterans foodstamp recipients; 500 hour work requirement.

<sup>3</sup> Estimates provided by the Congressional Budget Office (CBO).

<sup>4</sup> Loss of less than \$5 million.

<sup>5</sup> Loss of less than \$15 million.

<sup>6</sup> Loss of less than \$20 million.

<sup>7</sup> Gain of less than \$1 million.

<sup>8</sup> Revenue effect after 1/1/99 included in the revenue estimate for the safe harbor provision due to interactions between this provision and item II.C.4.

<sup>9</sup> Loss of less than \$10 million.

<sup>10</sup> Negligible revenue effect.

<sup>11</sup> This provision considers interaction effects of SIMPLE retirement plan provisions (Items IV.C.1, IV.C.2, and IV.D.5).

Legend for "Effective" column: ara=amounts received after; asda=annuity starting date after; dda=decadents dying after; DOE=data of enactment; eali GATT=effective as if included in GATT; gira=gross income received in taxable years beginning after; lma=loans made after; lya=limitation years beginning after; pba=property placed in service after; pbaa=prohibited transactions occurring after; pbaa=plan years beginning before; pbaa=taxable years beginning after; vpa DOE=vehicles purchased after date of enactment; yba=years beginning after; ybaa=years beginning before, on, or after; 90 da DOE=90 days after date of enactment.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

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

### ***Budget authority***

In compliance with subdivision (B) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions of the bill involve no new or increased budget authority.

### ***Tax expenditures***

In compliance with subdivision (B) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, the Committee states that the provisions involving income tax reductions generally involve increased tax expenditures and that the provisions involving increased income as revenues (see revenue table above) generally involve reduced tax expenditures. Non-income tax provisions are not classified as tax expenditures under the Budget Act. Also, certain reporting and other compliance provisions and technical corrections provisions do not involve tax expenditures.

## **C. Cost Estimate Prepared by the Congressional Budget Office**

In compliance with subdivisions (c) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives, requiring a cost estimate prepared by the Congressional Budget Office (CBO), the following statement by CBO is provided.

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, May 20, 1996.*

Hon. BILL ARCHER,  
*Chairman, Committee on Ways and Means,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office and the Joint Committee on Taxation (JCT) have reviewed H.R. 3448, the "Small Business Job Protection Act of 1996," as ordered reported by the House Committee on Ways and Means on May 14, 1996. The JCT estimates that this bill would increase governmental receipts by \$21 million in fiscal year 1996 and by \$171 million over fiscal years 1996 through 2003. CBO concurs with this estimate.

H.R. 3448 would increase the expensing limitation for small businesses, extend certain expiring provisions, simplify pension and foreign asset provisions, modify the tax treatment of Subchapter S Corporations and make technical corrections. In addition, the bill would repeal the possessions tax credit and the 50 percent interest income exclusion for financial institution loans to ESOPs, and make other changes that would increase taxes on corporations and other businesses. The revenue effects of H.R. 3448 are summarized in the table below. Please refer to the enclosed table for a more detailed estimate of the bill.

**Revenue Effects of H.R. 3448**  
[By fiscal year, in billions of dollars]

	1996	1997	1998	1999	2000	2001	2002	2003
Projected revenues under current law <sup>1</sup> .....	1,417.583	1,475.572	1,547.285	1,619.979	1,699.866	1,789.771	1,882.950	1,984.272
Proposed changes .....	0.021	-0.143	0.308	0.144	-0.271	-0.240	0.033	0.327
Projected revenues under H.R. 3448 .....	1,417.604	1,475.429	1,547.593	1,620.123	1,699.595	1,789.531	1,882.983	1,984.599

<sup>1</sup> Includes the revenue effects of P.L. 104-7 (H.R. 831), P.L. 104-104 (S. 652), P.L. 104-117 (H.R. 2778), P.L. 104-121 (H.R. 3136), P.L. 104-132 (S. 735), and P.L. 104-134 (H.R. 3019).

In accordance with the requirements of Public Law 104–4, the Unfunded Mandates Reform Act of 1995, JCT has determined that the bill contains no intergovernmental mandates, but does contain several private sector mandates. These provisions would impose direct costs on the private sector of more than \$100 million in each year from 1996–2000. The JCT estimates the direct mandate cost of tax increases in H.R. 3448 would total \$314 million in 1996, and about \$4.215 billion over the 1996–2000 period, as shown below:

**Federal Private Sector Mandates**

[By fiscal year, in millions of dollars]

	1996	1997	1998	1999	2000
Direct cost of tax increases .....	314	954	936	1,045	966

Please refer to the enclosed letter for a more detailed account of these provisions.

In addition to these mandates, the bill also provides for reductions in taxes. At this point, it is unclear to CBO whether these tax reductions should be viewed as offsets to the direct costs of the mandates in the bill. JCT estimates that the savings to the private sector associated with the tax reductions in H.R. 3448 would total \$310 million in 1996, and about \$4.477 billion over the 1996–2000 period, as shown below:

**Federal Private Sector Savings**

[By fiscal year, in millions of dollars]

	1996	1997	1998	1999	2000
Reductions in taxes .....	– 310	– 1,159	– 722	– 971	– 1,315

Section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting receipts or direct spending through 1998. Because the bill would affect receipts, pay-as-you-go procedures would apply to the bill. These effects are summarized in the table below.

**Pay-as-You-Go Considerations**

[By fiscal year, in millions of dollars]

	1996	1997	1998
Changes in receipts .....	21	– 143	308
Changes in outlays .....	Not applicable		

If you wish further details, please feel free to contact me or your staff may wish to contact Stephanie Weiner.

Sincerely,

JAMES L. BLUM  
(For June E. O'Neill, *Director*).



CONGRESS OF THE UNITED STATES,  
JOINT COMMITTEE ON TAXATION,  
*Washington, DC, May 17, 1996.*

Mrs. JUNE O'NEILL,  
*Director, Congressional Budget Office,  
U.S. Congress, Washington, DC.*

DEAR MRS. O'NEILL: We have reviewed H.R. 3448, the "Small Business Job Protection Act," as amended and ordered to be reported by the House Committee on Ways and Means on May 14, 1996. In accordance with the requirements of Public Law 104-4, the Unfunded Mandates Reform Act of 1995 (the "Unfunded Mandates Act"), we have determined that the following revenue provisions of the bill contain Federal private sector mandates: (1) the provision to repeal 5-year averaging for lump-sum distributions from qualified pension plans; (2) the provision to repeal the \$5,000 exclusion for employee death benefits; (3) the provision that would provide a simplified method for taxing annuity distributions under qualified pension plans; (4) the provision relating to adjustments to basis of inherited S corporation stock; (5) the provision to phase out the section 936 credit; (6) the provision to repeal the 50 percent interest income exclusion for financial institution loans to ESOPs; (7) the provision to modify the exclusion of damages received on account of personal injury or sickness; (8) the provision to reform the income forecast method of accounting; (9) the provision to apply a look-through the rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income; (10) the provision to repeal advance refunds of diesel fuel tax for diesel cars and light trucks; and (11) the provision to lower the reporting threshold for purchasers of fish from \$10,000 to \$600. The attached revenue table (items I.7., III.13., IV.A. 1, 2, and 3, and VI. 1., 2., 3., 4., 5., and 6.) generally reflects amounts that are no greater than the aggregate estimated amounts that the private sector will be required to spend in order to comply with these Federal private sector mandates. [See Part IV.A of the report for a copy of the revenue table.]

The revenue provisions of the bill, as amended, contain no inter-governmental mandates.

If you would like to discuss this matter in further detail, please feel free to contact me at 225-3621. Thank you for your cooperation in this matter.

Sincerely,

KENNETH J. KIES, *Chief of Staff.*

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

### **A. Committee Oversight Findings and Recommendations**

With respect to subdivision (A) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was the result of the Committee's oversight activities concerning the tax impact on small businesses and their workers, extension of certain expired tax provisions, tax treatment of subchapter S corporations, pension simplification, inclusion of certain earnings invested in excess passive assets, tax technical corrections, and certain revenue offsets necessary to make the bill budget neutral that the Committee concluded that it is appropriate and timely to enact the provisions contained in the bill as reported.

### **B. Summary of Findings and Recommendations of the Committee on Government Reform and Oversight**

With respect to subdivision (D) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee advises that no oversight findings or recommendations have been submitted to the Committee by the Committee on Government Reform and Oversight with respect to the provisions contained in the bill.

### **C. Inflationary Impact Statement**

In compliance with clause 2(l)(4) of Rule XI of the Rules of the House of Representatives, the Committee states that the tax reductions benefiting small businesses and workers are offset by certain revenue increases over the fiscal year period 1996–2003, and therefore the bill will not add to the budget deficit. Thus, the bill will not have any inflationary impact on costs and prices in the overall national economy.

### **D. Information Relating to Unfunded Mandates**

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the followings provisions of the bill contain Federal mandates on the private sector: (1) the provision to repeal 5-year averaging for lump-sum distributions from qualified pension plans; (2) the provision to repeal the \$5,000 exclusion for employee death benefits; (3) the provision that would provide a simplified method for taxing annuity distributions under qualified pension plans; (4) the provision relating to adjustments to basis of inherited S corporation stock; (5) the provision to phase out the section 936 credit; (6) the provision to repeal the 50 percent interest income exclusion for financial institution loans to ESOPs; (7)

the provision to modify the exclusion of damages received on account of personal injury or sickness; (8) the provision to reform the income forecast method of accounting; (9) the provision to apply a look-through rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income; (10) the provision to repeal advance refunds of diesel fuel tax for diesel cars and light trucks; and (11) the provision to lower the reporting threshold for purchasers of fish from \$10,000 to \$600.

The cost required to comply with each mandate generally is no greater than the revenue estimate for the provision. Benefits from the provisions include improved administration of the Federal income tax laws, simplification for individual taxpayers, and a more accurate measurement of gross income for Federal income tax purposes. The Committee believes the benefits of the bill are greater than the costs required to comply with the Federal private sector mandates contained in the bill.

The provision to repeal five-year averaging for lump-sum distributions from qualified pension plans results in a better measurement of gross income for Federal income tax purposes and encourages taxpayers to take qualified pension plan distributions in a form other than a lump-sum distribution. The provision to repeal the \$5,000 exclusion for employee death benefits results in a better measurement of gross income for Federal income tax purposes. The provision to provide a simplified method for taxing annuity distributions under qualified pension plans generally adopts an alternative method for taxing such distributions contained in Treasury regulations as the sole method for taxing such distributions and, thereby, simplifies the determination for individual taxpayers.

The provision relating to the adjustment to basis of inherited S corporation stock provides that a person acquiring stock in an S corporation from a decedent will treat as income in respect of a decedent ("IRD") his or her pro rata share of any item of income of the corporation that would have been IRD if that item had been acquired directly from the decedent, thereby improving the measurement of income for tax purposes.

The provision to phase out the section 936 credit with transition for companies that have existing operations in the possessions will result in the better measurement of gross income for Federal income tax purposes by eliminating a tax benefit enjoyed by only a small number of U.S. corporations operating in possessions.

The provision to repeal the 50-percent interest income exclusion for financial institution loans to ESOPs will result in a better measurement of the income of such financial institutions.

The provision to modify the exclusion of damages received on account of personal injury or sickness will simplify the administration of the Federal income tax laws by clarifying the taxation of damage awards and eliminating the need for additional litigation.

The provision to reform the income forecast method of accounting results in a better matching between income and depreciation deductions with respect to certain types of depreciable property.

The provision to apply a look-through rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income results in a better measurement of income by preventing unfair competition where operations involving the insur-

ance of third-party risks are conducted through a controlled foreign corporation that generally is subject to little tax relative to competing U.S. businesses.

The provision to repeal advance refunds of diesel fuel tax for diesel cars and light trucks results in a better measurement of income by repealing an obsolete credit for diesel fuel tax.

The provision to lower the reporting threshold for purchasers of fish from \$10,000 to \$600 will result in a better administration of the Federal tax laws by ensuring that the Internal Revenue Service has information reports with respect to more sales of fish.

The revenue-raising provisions of the bill are used to offset the cost of certain small business initiatives (including increased expensing, extension of the FICA tip credit to certain delivery persons, and pension and S corporation simplification provisions) and the extension of certain expiring provisions. These provisions are generally designed to relieve the burdens of Federal income taxation on individuals and small business and the revenue-raising provisions of the bill are critical to achieving these goals.

The revenue provisions of the bill do not contain any intergovernmental mandates.

The revenue provisions of the bill generally affect activities that are only engaged in by the private sector and, thus, do not affect the competitive balance between State, local, or tribal governments and the private sector.

#### **E. Applicability of House Rule XXI5(c)**

Rule XXI5(c) of the Rules of the House of Representatives provides that “No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless so determined by a vote of not less than three-fifths of the Members voting.” The Committee has carefully reviewed the provisions of the bill to determine whether any of these provisions constitute a Federal income tax rate increase within the meaning of the House rules. It is the opinion of the Committee that there is no provision in the bill that constitutes a Federal income tax rate increase within the meaning of House rule XXI5 (c) or (d).

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

In compliance with clause 3 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 I—TAX ON INDIVIDUALS

\* \* \* \* \*

#### SEC. 1. TAX IMPOSED.

(a) \* \* \*

\* \* \* \* \*

(g) CERTAIN UNEARNED INCOME OF MINOR CHILDREN TAXED AS IF PARENT'S INCOME.—

(1) \* \* \*

\* \* \* \* \*

(7) ELECTION TO CLAIM CERTAIN UNEARNED INCOME OF CHILD ON PARENT'S RETURN.—

(A) IN GENERAL.—

If—

(i) any child to whom this subsection applies has gross income for the taxable year only from interest and dividends (including Alaska Permanent Fund dividends),

[(ii) such gross income is more than \$500 and less than \$5,000,]

(ii) *such gross income is more than the amount described in paragraph (4)(A)(ii)(I) and less than 10 times the amount so described,*

\* \* \* \* \*

(B) INCOME INCLUDED ON PARENT'S RETURN.—In the case of a parent making the election under this paragraph—

(i) the gross income of each child to whom such election applies (to the extent the gross income of such child exceeds **[\$1,000]** *twice the amount described in paragraph (4)(A)(ii)(I)*) shall be included in such parent's gross income for the taxable year,

(ii) the tax imposed by this section for such year with respect to such parent shall be the amount equal to the sum of—

(I) the amount determined under this section after the application of clause (i), plus

**[(II) for each such child, the lesser of \$75 or 15 percent of the excess of the gross income of such child over \$500, and]**

*(II) for each such child, 15 percent of the lesser of the amount described in paragraph (4)(A)(ii)(I) or the excess of the gross income of such child over the amount so described, and*

\* \* \* \* \*

## PART IV—CREDITS AGAINST TAX

Subpart A. Nonrefundable personal credits.

\* \* \* \* \*

Subpart F. Rules for computing **[targeted jobs credit]** *work opportunity credit.*

\* \* \* \* \*

## PART IV—CREDITS AGAINST TAX

\* \* \* \* \*

### Subpart B—Foreign Tax Credit, Etc.

Sec. 27. Taxes of foreign countries and possessions of the United States; possession tax credit.

\* \* \* \* \*

Sec. 30A. *Puerto Rican economic activity credit.*

\* \* \* \* \*

## SEC. 30. CREDIT FOR QUALIFIED ELECTRIC VEHICLES.

(a) \* \* \*

\* \* \* \* \*

(d) SPECIAL RULES.—

(1) BASIS REDUCTION.—The basis of any property for which a credit is allowable under subsection (a) shall be reduced by the amount of such credit (*determined without regard to subsection (b)(3)*).

\* \* \* \* \*

(4) *ELECTION TO NOT TAKE CREDIT.*—No credit shall be allowed under subsection (a) for any vehicle if the taxpayer elects to not have this section apply to such vehicle.

\* \* \* \* \*

#### **SEC. 30A. PUERTO RICAN ECONOMIC ACTIVITY CREDIT.**

##### **(a) ALLOWANCE OF CREDIT.—**

(1) **IN GENERAL.**—Except as otherwise provided in this section, if the conditions of both paragraph (1) and paragraph (2) of subsection (b) are satisfied with respect to a qualified domestic corporation, there shall be allowed as a credit against the tax imposed by this chapter an amount equal to the portion of the tax which is attributable to the taxable income, from sources without the United States, from—

(A) the active conduct of a trade or business within Puerto Rico, or

(B) the sale or exchange of substantially all of the assets used by the taxpayer in the active conduct of such trade or business.

In the case of any taxable year beginning after December 31, 2001, the aggregate amount of taxable income taken into account under the preceding sentence (and in applying subsection (d)) shall not exceed the adjusted base period income of such corporation, as determined in the same manner as under section 936(j).

(2) **QUALIFIED DOMESTIC CORPORATION.**—For purposes of paragraph (1), the term “qualified domestic corporation” means a domestic corporation—

(A) which is an existing credit claimant with respect to Puerto Rico, and

(B) with respect to which section 936(a)(4)(B) does not apply for the taxable year.

(3) **SEPARATE APPLICATION.**—For purposes of determining—

(A) whether a taxpayer is an existing credit claimant with respect to Puerto Rico, and

(B) the amount of the credit allowed under this section, this section (and so much of section 936 as relates to this section) shall be applied separately with respect to Puerto Rico.

(b) **CONDITIONS WHICH MUST BE SATISFIED.**—The conditions referred to in subsection (a) are—

(1) **3-YEAR PERIOD.**—If 80 percent or more of the gross income of the qualified domestic corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession (determined without regard to section 904(f)).

(2) **TRADE OR BUSINESS.**—If 75 percent or more of the gross income of the qualified domestic corporation for such period or such part thereof was derived from the active conduct of a trade or business within a possession.

(c) **CREDIT NOT ALLOWED AGAINST CERTAIN TAXES.**—The credit provided by subsection (a) shall not be allowed against the tax imposed by—

- (1) section 59A (relating to environmental tax),
  - (2) section 531 (relating to the tax on accumulated earnings),
  - (3) section 541 (relating to personal holding company tax), or
  - (4) section 1351 (relating to recoveries of foreign expropriation losses).
- (d) **LIMITATIONS ON CREDIT FOR ACTIVE BUSINESS INCOME.**—The amount of the credit determined under subsection (a) for any taxable year shall not exceed the sum of the following amounts:
- (1) 60 percent of the sum of—
    - (A) the aggregate amount of the qualified domestic corporation's qualified possession wages for such taxable year, plus
    - (B) the allocable employee fringe benefit expenses of the qualified domestic corporation for such taxable year.
  - (2) The sum of—
    - (A) 15 percent of the depreciation allowances for the taxable year with respect to short-life qualified tangible property,
    - (B) 40 percent of the depreciation allowances for the taxable year with respect to medium-life qualified tangible property, and
    - (C) 65 percent of the depreciation allowances for the taxable year with respect to long-life qualified tangible property.
  - (3) If the qualified domestic corporation does not have an election to use the method described in section 936(h)(5)(C)(ii) (relating to profit split) in effect for the taxable year, the amount of the qualified possession income taxes for the taxable year allocable to nonsheltered income.
- (e) **ADMINISTRATIVE PROVISIONS.**—For purposes of this title—
- (1) the provisions of section 936 (including any applicable election thereunder) shall apply in the same manner as if the credit under this section were a credit under section 936(a)(1)(A) for a domestic corporation to which section 936(a)(4)(A) applies,
  - (2) the credit under this section shall be treated in the same manner as the credit under section 936, and
  - (3) a corporation to which this section applies shall be treated in the same manner as if it were a corporation electing the application of section 936.
- (f) **DEFINITIONS.**—For purposes of this section, any term used in this section which is also used in section 936 shall have the same meaning given such term by section 936.
- (g) **APPLICATION OF SECTION.**—This section shall apply to taxable years beginning after December 31, 1995, and before January 1, 2006.

### **Subpart C—Refundable Credits**

\* \* \* \* \*

#### **SEC. 34. CERTAIN USES OF GASOLINE AND SPECIAL FUELS.**

- (a) **GENERAL RULE.**—There shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the sum of the amounts payable to the taxpayer—



(1) \* \* \*

\* \* \* \* \*

[(3) under section 6427—

[(A) with respect to fuels used for nontaxable purposes or resold, or

[(B) with respect to any qualified diesel-powered highway vehicle purchased (or deemed purchased under section 6427(g)(6)), during the taxable year (determined without regard to section 6427(k)).]

(3) *under section 6427 with respect to fuels used for nontaxable purposes or resold during the taxable year (determined without regard to section 6427(k)).*

\* \* \* \* \*

#### Subpart D—Business Related Credits

\* \* \* \* \*

#### SEC. 38. GENERAL BUSINESS CREDIT.

(a) \* \* \*

(b) CURRENT YEAR BUSINESS CREDIT.—For purposes of this subpart, the amount of the current year business credit is the sum of the following credits determined for the taxable year:

(1) the investment credit determined under section 46,

(2) the [targeted jobs credit] *work opportunity credit* determined under section 51(a),

\* \* \* \* \*

#### SEC. 39. CARRYBACK AND CARRYFORWARD OF UNUSED CREDITS.

(a) \* \* \*

\* \* \* \* \*

(d) TRANSITIONAL RULES.—

(1) \* \* \*

\* \* \* \* \*

(5) NO CARRYBACK OF SECTION [45] 45A CREDIT BEFORE ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to the Indian employment credit determined under section 45A may be carried to a taxable year ending before the date of the enactment of section 45A.

(6) NO CARRYBACK OF SECTION [45] 45B CREDIT BEFORE ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to the employer social security credit determined under section 45B may be carried back to a taxable year ending before the date of the enactment of section 45B.

#### SEC. 40. ALCOHOL USED AS FUEL.

(a) \* \* \*

\* \* \* \* \*

(e) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any sale or use—

(A) for any period after December 31, 2000, or  
 [(B) for any period before January 1, 2001, during which  
 the Highway Trust Fund financing rate under section  
 4081(a)(2) is not in effect.]

*(B) for any period before January 1, 2001, during which  
 the rates of tax under section 4081(a)(2)(A) are 4.3 cents per  
 gallon.*

\* \* \* \* \*

#### **SEC. 42. LOW-INCOME HOUSING CREDIT.**

(a) \* \* \*

\* \* \* \* \*

(c) **QUALIFIED BASIS; QUALIFIED LOW-INCOME BUILDING.**—For purposes of this section—

(1) \* \* \*

(2) **QUALIFIED LOW-INCOME BUILDING.**—The term “qualified low-income building” means any building—

(A) which is part of a qualified low-income housing project at all times during the period—

(i) beginning on the 1st day in the compliance period on which such building is part of such a project, and

(ii) ending on the last day of the compliance period with respect to such building, and

(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

Such term does not include any building with respect to which moderate rehabilitation assistance is provided, at any time during the compliance period, under section 8(e)(2) of the United States Housing Act of 1937 (other than assistance under the Stewart B. McKinney Homeless Assistance Act [of 1988] (as in effect on the date of the enactment of this sentence)).

\* \* \* \* \*

#### **SEC. 45B. CREDIT FOR PORTION OF EMPLOYER SOCIAL SECURITY TAXES PAID WITH RESPECT TO EMPLOYEE CASH TIPS.**

(a) \* \* \*

(b) **EXCESS EMPLOYER SOCIAL SECURITY TAX.**—For purposes of this section—

(1) **IN GENERAL.**—The term “excess employer social security tax” means any tax paid by an employer under section 3111 with respect to tips received by an employee during any month, to the extent such tips—

(A) are deemed to have been paid by the employer to the employee pursuant to section 3121(q) *(without regard to whether such tips are reported under section 6053)*, and

\* \* \* \* \*

[(2) **ONLY TIPS RECEIVED AT FOOD AND BEVERAGE ESTABLISHMENTS TAKEN INTO ACCOUNT.**—In applying paragraph (1), there shall be taken into account only tips received from customers in connection with the provision of food or beverages for consumption on the premises of an establishment with respect to which the tipping of employees serving food or beverages by customers is customary.]

(2) *ONLY TIPS RECEIVED FOR FOOD OR BEVERAGES TAKEN INTO ACCOUNT.*—In applying paragraph (1), there shall be taken into account only tips received from customers in connection with the delivering or serving of food or beverages for consumption if the tipping of employees delivering or serving food or beverages by customers is customary.

\* \* \* \* \*

### Subpart E—Rules for Computing Investment Credit

\* \* \* \* \*

#### SEC. 50. OTHER SPECIAL RULES.

(a) **RECAPTURE IN CASE OF DISPOSITIONS, ETC.**—Under regulations prescribed by the Secretary—

(1) \* \* \*

(2) **PROPERTY CEASES TO QUALIFY FOR PROGRESS EXPENDITURES.**—

(A) \* \* \*

(C) **CERTAIN SALES AND LEASEBACKS.**—Under regulations prescribed by the Secretary, a sale by, and leaseback to, a taxpayer who, when the property is placed in service, will be a lessee to whom the rules referred to in [subsection (c)(4)] *subsection (d)(5)* apply shall not be treated as a cessation described in subparagraph (A) to the extent that the amount which will be passed through to the lessee under such rules with respect to such property is not less than the qualified rehabilitation expenditures properly taken into account by the lessee under section 47(d) with respect to such property.

\* \* \* \* \*

(E) **SPECIAL RULES.**—Rules similar to the rules of this paragraph shall apply in cases where qualified progress expenditures were taken into account under the rules referred to in [section 48(a)(5)(A)] *section 48(a)(5)*.

\* \* \* \* \*

### Subpart F—Rules for Computing [Targeted Jobs Credit] *Work Opportunity Credit*

\* \* \* \* \*

#### SEC. 51. AMOUNT OF CREDIT.

(a) **DETERMINATION OF AMOUNT.**—For purposes of section 38, the amount of the [targeted jobs credit] *work opportunity credit* determined under this section for the taxable year shall be equal to [40 percent] *35 percent* of the qualified first-year wages for such year.

\* \* \* \* \*

(c) **WAGES DEFINED.**—For purposes of this subpart—

(1) **IN GENERAL.**—Except as otherwise provided in this subsection[, subsection (d)(8)(D).] and subsection (h)(2), the term “wages” has the meaning given to such term by sub-

section (b) of section 3306 (determined without regard to any dollar limitation contained in such section).

\* \* \* \* \*

[(4) TERMINATION.—The term “wages” shall not include any amount paid or incurred to an individual who begins work for the employer after December 31, 1994.]

(4) *TERMINATION.—The term “wages” shall not include any amount paid or incurred to an individual who begins work for the employer—*

(A) *after December 31, 1994, and before July 1, 1996, or*  
(B) *after June 30, 1997.*

[(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—

[(1) IN GENERAL.—An individual is a member of a targeted group if such individual is—

[(A) a vocational rehabilitation referral,

[(B) an economically disadvantaged youth,

[(C) an economically disadvantaged Vietnam-era veteran,

[(D) an SSI recipient,

[(E) a general assistance recipient,

[(F) a youth participating in a cooperative education program,

[(G) an economically disadvantaged ex-convict,

[(H) an eligible work incentive employee,

[(I) an involuntarily terminated CETA employee, or

[(J) a qualified summer youth employee.

[(2) VOCATIONAL REHABILITATION REFERRAL.—The term “vocational rehabilitation referral” means any individual who is certified by the designated local agency as—

[(A) having a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

[(B) having been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to—

[(i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or

[(ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code.

[(3) ECONOMICALLY DISADVANTAGED YOUTH.—

[(A) IN GENERAL.—The term “economically disadvantaged youth” means any individual who is certified by the designated local agency as—

[(i) meeting the age requirements of subparagraph (B), and

[(ii) being a member of an economically disadvantaged family (as determined under paragraph (11)).

[(B) AGE REQUIREMENTS.—An individual meets the age requirements of this subparagraph if such individual has attained age 18 but not age 23 on the hiring date.

[(4) VIETNAM VETERAN WHO IS A MEMBER OF AN ECONOMICALLY DISADVANTAGED FAMILY.—The term “Vietnam veteran

who is a member of an economically disadvantaged family” means any individual who is certified by the designated local agency as—

[(A)(i) having served on active duty (other than active duty for training) in the Armed Forces of the United States for a period of more than 180 days, any part of which occurred after August 4, 1964, and before May 8, 1975, or

[(ii) having been discharged or released from active duty in the Armed Forces of the United States for a service-connected disability if any part of such active duty was performed after August 4, 1964, and before May 8, 1975,

[(B) not having any day during the preemployment period which was a day of extended active duty in the Armed Forces of the United States, and

[(C) being a member of an economically disadvantaged family (determined under paragraph (11)).

For purposes of subparagraph (B), the term “extended active duty” means a period of more than 90 days during which the individual was on active duty (other than active duty for training).

[(5) SSI RECIPIENTS.—The term “SSI recipient” means any individual who is certified by the designated local agency as receiving supplemental security income benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section 212 of Public Law 93-66) for any month ending in the pre-employment period.

[(6) GENERAL ASSISTANCE RECIPIENTS.—

[(A) IN GENERAL.—The term “general assistance recipient” means any individual who is certified by the designated local agency as receiving assistance under a qualified general assistance program for any period of not less than 30 days ending within the preemployment period.

[(B) QUALIFIED GENERAL ASSISTANCE PROGRAM.—The term “qualified general assistance program” means any program of a State or a political subdivision of a State—

[(i) which provides general assistance or similar assistance which—

[(I) is based on need, and

[(II) consists of money payments or voucher or scrip, and

[(ii) which is designated by the Secretary (after consultation with the Secretary of Health and Human Services) as meeting the requirements of clause (i).

[(7) ECONOMICALLY DISADVANTAGED EX-CONVICT.—The term “economically disadvantaged ex-convict” means any individual who is certified by the designated local agency—

[(A) as having been convicted of a felony under any statute of the United States or any State,

[(B) as being a member of an economically disadvantaged family (as determined under paragraph (11)), and

[(C) as having a hiring date which is not more than 5 years after the last date on which such individual was so convicted or was released from prison.

[(8) YOUTH PARTICIPATING IN A QUALIFIED COOPERATIVE EDUCATION PROGRAM.—

[(A) IN GENERAL.—The term “youth participating in a qualified cooperative education program” means any individual who is certified by the school participating in the program as—

[(i) having attained age 16 and not having attained age 20,

[(ii) not having graduated from a high school or vocational school,

[(iii) being enrolled in and actively pursuing a qualified cooperative education program, and

[(iv) being a member of an economically disadvantaged family (as determined under paragraph (11)).

[(B) QUALIFIED COOPERATIVE EDUCATION PROGRAM DEFINED.—The term “qualified cooperative education program” means a program of vocational education for individuals who (through written cooperative arrangements between a qualified school and 1 or more employers) receive instruction (including required academic instruction) by alternation of study and school with a job in any occupational field (but only if these 2 experiences are planned by the school and employer so that each contributes to the student’s education and employability).

[(C) QUALIFIED SCHOOL DEFINED.—The term “qualified school” means—

[(i) a specialized high school used exclusively or principally for the provision of vocational education to individuals who are available for study in preparation for entering the labor market,

[(ii) the department of a high school exclusively or principally used for providing vocational education to persons who are available for study in preparation for entering the labor market, or

[(iii) a technical or vocational school used exclusively or principally for the provision of vocational education to persons who have completed or left high school and who are available for study in preparation for entering the labor market.

A school which is not a public school shall be treated as a qualified school only if it is exempt from tax under section 501(a).

[(D) WAGES.—In the case of remuneration attributable to services performed while the individual meets the requirements of clauses (i), (ii), and (iii) of subparagraph (A), wages, and unemployment insurance wages, shall be determined without regard to section 3306(c)(10)(C).

[(9) ELIGIBLE WORK INCENTIVE EMPLOYEES.—The term “eligible work incentive employee” means an individual who has been certified by the designated local agency as—

[(A) being eligible for financial assistance under part A of title IV of the Social Security Act and as having continually received such financial assistance during the 90-day

period which immediately precedes the date on which such individual is hired by the employer, or

[(B) having been placed in employment under a work incentive program established under section 432(b)(1) or 445 of the Social Security Act.

[(10) INVOLUNTARILY TERMINATED CETA EMPLOYEE.—The term “involuntarily terminated CETA employee” means an individual who is certified by the designated local agency as having been involuntarily terminated after December 31, 1980, from employment financed in whole or in part under a program under part D of title II or title VI of the Comprehensive Employment and Training Act. This paragraph shall not apply to any individual who begins work for the employer after December 31, 1982.

[(11) MEMBERS OF ECONOMICALLY DISADVANTAGED FAMILIES.—An individual is a member of an economically disadvantaged family if the designated local agency determines that such individual was a member of a family which had an income during the 6 months immediately preceding the earlier of the month in which such determination occurs or the month in which the hiring date occurs, which, on an annual basis, would be 70 percent or less of the Bureau of Labor Statistics lower living standard. Any such determination shall be valid for the 45-day period beginning on the date such determination is made. Any such determination with respect to an individual who is a qualified summer youth employee or youth participating in a qualified cooperative education program with respect to any employer shall also apply for purposes of determining whether such individual is a member of another targeted group with respect to such employer.

[(12) QUALIFIED SUMMER YOUTH EMPLOYEE.—

[(A) IN GENERAL.—The term “qualified summer youth employee” means an individual—

[(i) who performs services for the employer between May 1 and September 15,

[(ii) who is certified by the designated local agency as having attained age 16 but not 18 on the hiring date (or if later, on May 1 of the calendar year involved),

[(iii) who has not been an employee of the employer during any period prior to the 90-day period described in subparagraph (B)(iii), and

[(iv) who is certified by the designated local agency as being a member of an economically disadvantaged family (as determined under paragraph (11)).

[(B) SPECIAL RULES FOR DETERMINING AMOUNT OF CREDIT.—For purposes of applying this subpart to wages paid or incurred to any qualified summer youth employee—

[(i) subsection (b)(2) shall be applied by substituting “any 90-day period between May 1 and September 15” for “the 1-year period beginning with the day the individual begins work for the employer”, and

[(ii) subsection (b)(3) shall be applied by substituting “\$3,000” for “\$6,000”.

[(C) SPECIAL RULE FOR CONTINUED EMPLOYMENT FOR SAME EMPLOYER.—In the case of an individual who, with respect to the same employer, is certified as a member of another targeted group after such individual has been a qualified summer youth employee, paragraph (14) shall be applied by substituting “certified” for “hired by the employer”.

[(13) PREEMPLOYMENT PERIOD.—The term “preemployment period” means the 60-day period ending on the hiring date.

[(14) HIRING DATE.—The term “hiring date” means the day the individual is hired by the employer.

[(15) DESIGNATED LOCAL AGENCY.—The term “designated local agency” means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49–49n).

[(16) SPECIAL RULES FOR CERTIFICATIONS.—

[(A) IN GENERAL.—An individual shall not be treated as a member of a targeted group unless, on or before the day on which such individual begins work for the employer, the employer—

[(i) has received a certification from a designated local agency that such individual is a member of a targeted group, or

[(ii) has requested in writing such certification from the designated local agency.

For purposes of the preceding sentence, if on or before the day on which such individual begins work for the employer, such individual has received from a designated local agency (or other agency or organization designated pursuant to a written agreement with such designated local agency) a written preliminary determination that such individual is a member of a targeted group, then “the fifth day” shall be substituted for “the day” in such sentence.

[(B) INCORRECT CERTIFICATIONS.—If—

[(i) an individual has been certified as a member of a targeted group, and

[(ii) such certification is incorrect because it was based on false information provided by such individual, the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages.

[(C) EMPLOYER REQUEST MUST SPECIFY POTENTIAL BASIS FOR ELIGIBILITY.—In any request for a certification of an individual as a member of a targeted group, the employer shall—

[(i) specify each subparagraph (but not more than 2) of paragraph (1) by reason of which the employer believes that such individual is such a member, and

[(ii) certify that a good faith effort was made to determine that such individual is such a member.]

(d) MEMBERS OF TARGETED GROUPS.—For purposes of this subpart—



(1) *IN GENERAL.*—An individual is a member of a targeted group if such individual is—

- (A) a qualified IV-A recipient,
- (B) a qualified veteran,
- (C) a qualified ex-felon,
- (D) a high-risk youth,
- (E) a vocational rehabilitation referral, or
- (F) a qualified summer youth employee.

(2) *QUALIFIED IV-A RECIPIENT.*—

(A) *IN GENERAL.*—The term “qualified IV-A recipient” means any individual who is certified by the designated local agency as being a member of a family receiving assistance under a IV-A program for at least a 9-month period ending during the 9-month period ending on the hiring date.

(B) *IV-A PROGRAM.*—For purposes of this paragraph, the term “IV-A program” means any program providing assistance under a State plan approved under part A of title IV of the Social Security Act (relating to assistance for needy families with minor children) and any successor of such program.

(3) *QUALIFIED VETERAN.*—

(A) *IN GENERAL.*—The term “qualified veteran” means any veteran who is certified by the designated local agency as being—

(i) a member of a family receiving assistance under a IV-A program (as defined in paragraph (2)(B)) for at least a 9-month period ending during the 12-month period ending on the hiring date, or

(ii) a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.

(B) *VETERAN.*—For purposes of subparagraph (A), the term “veteran” means any individual who is certified by the designated local agency as—

(i)(I) having served on active duty (other than active duty for training) in the Armed Forces of the United States for a period of more than 180 days, or

(II) having been discharged or released from active duty in the Armed Forces of the United States for a service-connected disability, and

(ii) not having any day during the 60-day period ending on the hiring date which was a day of extended active duty in the Armed Forces of the United States.

For purposes of clause (ii), the term “extended active duty” means a period of more than 90 days during which the individual was on active duty (other than active duty for training).

(4) *QUALIFIED EX-FELON.*—The term “qualified ex-felon” means any individual who is certified by the designated local agency—

(A) as having been convicted of a felony under any statute of the United States or any State,

(B) as having a hiring date which is not more than 1 year after the last date on which such individual was so convicted or was released from prison, and

(C) as being a member of a family which had an income during the 6 months immediately preceding the earlier of the month in which such income determination occurs or the month in which the hiring date occurs, which, on an annual basis, would be 70 percent or less of the Bureau of Labor Statistics lower living standard.

Any determination under subparagraph (C) shall be valid for the 45-day period beginning on the date such determination is made.

(5) *HIGH-RISK YOUTH.*—

(A) *IN GENERAL.*—The term “high-risk youth” means any individual who is certified by the designated local agency—

(i) as having attained age 18 but not age 25 on the hiring date, and

(ii) as having his principal place of abode within an empowerment zone or enterprise community.

(B) *YOUTH MUST CONTINUE TO RESIDE IN ZONE.*—In the case of a high-risk youth, the term “qualified wages” shall not include wages paid or incurred for services performed while such youth’s principal place of abode is outside an empowerment zone or enterprise community.

(6) *VOCATIONAL REHABILITATION REFERRAL.*—The term “vocational rehabilitation referral” means any individual who is certified by the designated local agency as—

(A) having a physical or mental disability which, for such individual, constitutes or results in a substantial handicap to employment, and

(B) having been referred to the employer upon completion of (or while receiving) rehabilitative services pursuant to—

(i) an individualized written rehabilitation plan under a State plan for vocational rehabilitation services approved under the Rehabilitation Act of 1973, or

(ii) a program of vocational rehabilitation carried out under chapter 31 of title 38, United States Code.

(7) *QUALIFIED SUMMER YOUTH EMPLOYEE.*—

(A) *IN GENERAL.*—The term “qualified summer youth employee” means any individual—

(i) who performs services for the employer between May 1 and September 15,

(ii) who is certified by the designated local agency as having attained age 16 but not 18 on the hiring date (or if later, on May 1 of the calendar year involved),

(iii) who has not been an employee of the employer during any period prior to the 90-day period described in subparagraph (B)(i), and

(iv) who is certified by the designated local agency as having his principal place of abode within an empowerment zone or enterprise community.

(B) *SPECIAL RULES FOR DETERMINING AMOUNT OF CREDIT.*—For purposes of applying this subpart to wages paid or incurred to any qualified summer youth employee—

(i) subsection (b)(2) shall be applied by substituting “any 90-day period between May 1 and September 15” for “the 1-year period beginning with the day the individual begins work for the employer”, and

(ii) subsection (b)(3) shall be applied by substituting “\$3,000” for “\$6,000”.

The preceding sentence shall not apply to an individual who, with respect to the same employer, is certified as a member of another targeted group after such individual has been a qualified summer youth employee.

(C) *YOUTH MUST CONTINUE TO RESIDE IN ZONE.*—Paragraph (5)(B) shall apply for purposes of this paragraph.

(8) *HIRING DATE.*—The term “hiring date” means the day the individual is hired by the employer.

(9) *DESIGNATED LOCAL AGENCY.*—The term “designated local agency” means a State employment security agency established in accordance with the Act of June 6, 1933, as amended (29 U.S.C. 49–49n).

(10) *SPECIAL RULES FOR CERTIFICATIONS.*—

(A) *IN GENERAL.*—An individual shall not be treated as a member of a targeted group unless—

(i) on or before the day on which such individual begins work for the employer, the employer has received a certification from a designated local agency that such individual is a member of a targeted group, or

(ii)(I) on or before the day the individual is offered employment with the employer, a pre-screening notice is completed by the employer with respect to such individual, and

(II) not later than the 14th day after the individual begins work for the employer, the employer submits such notice, signed by the employer and the individual under penalties of perjury, to the designated local agency as part of a written request for such a certification from such agency.

For purposes of this paragraph, the term “pre-screening notice” means a document (in such form as the Secretary shall prescribe) which contains information provided by the individual on the basis of which the employer believes that the individual is a member of a targeted group.

(B) *INCORRECT CERTIFICATIONS.*—If—

(i) an individual has been certified by a designated local agency as a member of a targeted group, and

(ii) such certification is incorrect because it was based on false information provided by such individual,

the certification shall be revoked and wages paid by the employer after the date on which notice of revocation is received by the employer shall not be treated as qualified wages.

(C) *EXPLANATION OF DENIAL OF REQUEST.*—If a designated local agency denies a request for certification of membership in a targeted group, such agency shall provide

*to the person making such request a written explanation of the reasons for such denial.*

\* \* \* \* \*

(i) CERTAIN INDIVIDUALS INELIGIBLE.—

(1) \* \* \*

\* \* \* \* \*

[(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

[(A) is employed by the employer at least 90 days (14 days in the case of an individual described in subsection (d)(12)), or

[(B) has completed at least 120 hours (20 hours in the case of an individual described in subsection (d)(12)) of services performed for the employer.]

(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

(A) is employed by the employer at least 180 days (20 days in the case of a qualified summer youth employee), or

(B) has completed at least 500 hours (120 hours in the case of a qualified summer youth employee) of services performed for the employer.

\* \* \* \* \*

**Subpart G—Credit Against Regular Tax for Prior Year Minimum Tax Liability**

\* \* \* \* \*

**SEC. 53. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.**

(a) \* \* \*

\* \* \* \* \*

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

(1) NET MINIMUM TAX.—

(A) IN GENERAL.—The term “net minimum tax” means the tax imposed by section 55.

(B) CREDIT NOT ALLOWED FOR EXCLUSION PREFERENCES.—

(i) \* \* \*

\* \* \* \* \*

(iv) CREDIT ALLOWABLE FOR EXCLUSION PREFERENCES OF CORPORATIONS.—In the case of a corporation—

(I) the preceding provisions of this subparagraph shall not apply, and

[(II) the adjusted net minimum tax for any taxable year is the amount of the net minimum tax for such year increased by the amount of any credit not allowed under section 29 solely by reason of the application of section 29(b)(5)(B) or not al-

lowed under section 28 solely by reason of the application of section 28(d)(2)(B).】

(II) *the adjusted net minimum tax for any taxable year is the amount of the net minimum tax for such year increased in the manner provided in clause (iii).*

\* \* \* \* \*

## PART VI—ALTERNATIVE MINIMUM WAGE

\* \* \* \* \*

### SEC. 55. ALTERNATIVE MINIMUM TAX IMPOSED.

(a) \* \* \*

\* \* \* \* \*

(c) REGULAR TAX.—

(1) IN GENERAL.—For purposes of this section, the term “regular tax” means the regular tax liability for the taxable year (as defined in section 26(b)) reduced by the foreign tax credit allowable under section 27(a) [and the section 936 credit allowable under section 27(b)], *the section 936 credit allowable under section 27(b), and the Puerto Rican economic activity credit under section 30A.* Such term [shall not include any tax imposed by section 402(d) and] shall not include any increase in tax under section 49(b) or 50(a) or subsection (j) or (k) of section 42.

\* \* \* \* \*

### 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) \* \* \*

(B) in determining the amount of such deduction—

(i) the net operating loss (within the meaning of section 172(c)) for any loss year shall be adjusted as provided in paragraph (2), and

[(ii) in the case of taxable years beginning after December 31, 1986, section 172(b)(2) shall be applied by substituting “90 percent of alternative minimum taxable income determined without regard to the alternative tax net operating loss deduction” for “taxable income” each place it appears.】

*(ii) appropriate adjustments in the application of section 172(b)(2) shall be made to take into account the limitation of subparagraph (A).*

\* \* \* \* \*

## (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) \* \* \*

(ii) SPECIAL RULE FOR CERTAIN DIVIDENDS.—

(I) IN GENERAL.—Clause (i) shall not apply to any deduction allowable under section 243 or 245 for any dividend which is a 100-percent dividend or which is received from a 20-percent owned corporation (as defined in section 243(c)(2)), but only to the extent such dividend is attributable to income of the paying corporation which is subject to tax under this chapter determined after the application of sections 30A, 936 (including subsections (a)(4) [and (i)], (i), and (j) thereof) and 921.

(II) 100-PERCENT DIVIDEND.—For purposes [of the subclause] of subclause (I), the term “100 percent dividend” means any dividend if the percentage used for purposes of determining the amount allowable as a deduction under section 243 or 245 with respect to such dividend is 100 percent.

(iii) TREATMENT OF TAXES ON DIVIDENDS FROM 936 CORPORATIONS.—

(I) \* \* \*

\* \* \* \* \*

(VI) APPLICATION TO SECTION 30A CORPORATIONS.—References in this clause to section 936 shall be treated as including references to section 30A.

(D) CERTAIN OTHER EARNINGS AND PROFITS ADJUSTMENTS.—

(i) \* \* \*

\* \* \* \* \*

(iii) LIFO INVENTORY ADJUSTMENTS.—The adjustments provided in section 312(n)(4) shall apply, *but only with respect to taxable years beginning after December 31, 1989.*

\* \* \* \* \*

[(I)] (H) ADJUSTED BASIS.—The adjusted basis of any property with respect to which an adjustment under this paragraph applies shall be determined by applying the treatment prescribed in this paragraph.

[(J)] (I) TREATMENT OF CHARITABLE CONTRIBUTIONS.—Notwithstanding subparagraphs (B) and (C), no adjustment related to the earnings and profits effects of any

charitable contribution shall be made in computing adjusted current earnings.

\* \* \* \* \*

**SEC. 59. OTHER DEFINITIONS AND SPECIAL RULES.**

(a) **ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT.**—For purposes of this part—

(1) **IN GENERAL.**—The alternative minimum tax foreign tax credit for any taxable year shall be the credit which would be determined under section 27(a) for such taxable year if—

(A) **the amount determined under section 55(b)(1)(A) the pre-credit tentative minimum tax** were the tax against which such credit was taken for purposes of section 904 for the taxable year and all prior taxable years beginning after December 31, 1986,

(B) section 904 were applied on the basis of alternative minimum taxable income instead of taxable income, and

(C) the determination of whether any income is high-taxed income for purposes of section 904(d)(2) were made on the basis of the applicable rate **specified in section 55(b)(1)(A) specified in subparagraph (A)(i) or (B)(i) of section 55(b)(1) (whichever applies)** in lieu of the highest rate of tax specified in section 1 or 11 (whichever applies).

(2) **LIMITATION TO 90 PERCENT OF TAX.**—

(A) **IN GENERAL.**—The alternative minimum tax foreign tax credit for any taxable year shall not exceed the excess (if any) of—

(i) **the amount determined under section 55(b)(1)(A) the pre-credit tentative minimum tax** for the taxable year, over

(ii) 10 percent of the amount **which would be determined under section 55(b)(1)(A) which would be the pre-credit tentative minimum tax** without regard to the alternative tax net operating loss deduction and section 57(a)(2)(E).

\* \* \* \* \*

(3) **PRE-CREDIT TENTATIVE MINIMUM TAX.**—For purposes of this subsection, the term “pre-credit tentative minimum tax” means—

(A) *in the case of a taxpayer other than a corporation, the amount determined under the first sentence of section 55(b)(1)(A)(i), or*

(B) *in the case of a corporation, the amount determined under section 55(b)(1)(B)(i).*

\* \* \* \* \*

(b) **MINIMUM TAX NOT TO APPLY TO INCOME ELIGIBLE FOR SECTION 936 CREDIT.**—In the case of any corporation for which a credit is allowable for the taxable year under **section 936, alternative minimum taxable income shall not include any amount with respect to which the requirements of subparagraph (A) or (B) of section 936(a)(1) are met. section 30A or 936, alternative minimum**

*taxable income shall not include any income with respect to which a credit is determined under section 30A or 936.*

\* \* \* \* \*

(d) APPORTIONMENT OF DIFFERENTLY TREATED ITEMS IN CASE OF CERTAIN ENTITIES.—

(1) IN GENERAL. The differently treated items for the taxable year shall be apportioned (in accordance with regulations prescribed by the Secretary)—

(A) \* \* \*

(B) COMMON TRUST FUNDS.—In the case of a common trust fund (as defined in section 584(a)), pro rata among the participants of such fund.

\* \* \* \* \*

(j) TREATMENT OF UNEARNED INCOME OF MINOR CHILDREN.—

(1) LIMITATION ON EXEMPTION AMOUNT.—In the case of a child to whom section 1(g) applies, the exemption amount for purposes of section 55 shall not exceed the sum of—

(A) such child's earned income (as defined in section 911(d)(2)) for the taxable year, plus

(B) **[\$1,000]** *twice the amount in effect for the taxable year under section 63(c)(5)(A)* (or, if greater, the child's share of the unused parental minimum tax exemption).

\* \* \* \* \*

(3) UNUSED PARENTAL MINIMUM TAX EXEMPTION.—

(A) \* \* \*

(B) CERTAIN RULES MADE APPLICABLE.—A child's share of any unused parental minimum tax exemption shall be determined under rules similar to the rules of **[section 1(g)(3)(B), and rules similar to the rules of paragraphs (3)(D) and (5) of section 1(g)]** shall apply for purposes of this paragraph.

\* \* \* \* \*

## Subchapter B—Computation of Taxable Income

\* \* \* \* \*

### PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME, ETC.

\* \* \* \* \*

#### SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term “adjusted gross income” means, in the case of an individual, gross income minus the following deductions:

(1) \* \* \*

\* \* \* \* \*

**[(8) CERTAIN PORTION OF LUMP-SUM DISTRIBUTIONS FROM PENSION PLANS TAXED UNDER SECTION 402(d).—The deduction allowed by section 402(d)(3).]**

\* \* \* \* \*



**PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS  
INCOME**

\* \* \* \* \*

**SEC. 72. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE  
INSURANCE CONTRACTS.**

(a) \* \* \*

(b) **EXCLUSION RATIO.**—

(1) \* \* \*

\* \* \* \* \*

(4) **UNRECOVERED INVESTMENT.**—For purposes of this subsection, the unrecovered investment in the contract as of any date is—

(A) the investment in the contract (*determined without regard to subsection (c)(2)*) as of the annuity starting date, reduced by

(B) the aggregate amount received under the contract on or after such annuity starting date and before the date as of which the determination is being made, to the extent such amount was excludable from gross income under this subtitle.

\* \* \* \* \*

**[(d) TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS AS SEPARATE CONTRACTS.**—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract.]

(d) **SPECIAL RULES FOR QUALIFIED EMPLOYER RETIREMENT PLANS.**—

(1) **SIMPLIFIED METHOD OF TAXING ANNUITY PAYMENTS.**—

(A) **IN GENERAL.**—*In the case of any amount received as an annuity under a qualified employer retirement plan—*

*(i) subsection (b) shall not apply, and*

*(ii) the investment in the contract shall be recovered as provided in this paragraph.*

(B) **METHOD OF RECOVERING INVESTMENT IN CONTRACT.**—

*(i) IN GENERAL.*—Gross income shall not include so much of any monthly annuity payment under a qualified employer retirement plan as does not exceed the amount obtained by dividing—

*(I) the investment in the contract (as of the annuity starting date), by*

*(II) the number of anticipated payments determined under the table contained in clause (iii) (or, in the case of a contract to which subsection (c)(3)(B) applies, the number of monthly annuity payments under such contract).*

*(ii) CERTAIN RULES MADE APPLICABLE.*—Rules similar to the rules of paragraphs (2) and (3) of subsection (b) shall apply for purposes of this paragraph.

*(iii) NUMBER OF ANTICIPATED PAYMENTS.*—

<i>If the age of the primary annuitant on the annuity starting date is:</i>	<i>The number of anticipated payments is:</i>
<i>Not more than 55 .....</i>	<i>360</i>
<i>More than 55 but not more than 60 .....</i>	<i>310</i>
<i>More than 60 but not more than 65 .....</i>	<i>260</i>
<i>More than 65 but not more than 70 .....</i>	<i>210</i>
<i>More than 70 .....</i>	<i>160.</i>

(C) **ADJUSTMENT FOR REFUND FEATURE NOT APPLICABLE.**—For purposes of this paragraph, investment in the contract shall be determined under subsection (c)(1) without regard to subsection (c)(2).

(D) **SPECIAL RULE WHERE LUMP SUM PAID IN CONNECTION WITH COMMENCEMENT OF ANNUITY PAYMENTS.**—If, in connection with the commencement of annuity payments under any qualified employer retirement plan, the taxpayer receives a lump sum payment—

- (i) such payment shall be taxable under subsection (e) as if received before the annuity starting date, and
- (ii) the investment in the contract for purposes of this paragraph shall be determined as if such payment had been so received.

(E) **EXCEPTION.**—This paragraph shall not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity.

(F) **ADJUSTMENT WHERE ANNUITY PAYMENTS NOT ON MONTHLY BASIS.**—In any case where the annuity payments are not made on a monthly basis, appropriate adjustments in the application of this paragraph shall be made to take into account the period on the basis of which such payments are made.

(G) **QUALIFIED EMPLOYER RETIREMENT PLAN.**—For purposes of this paragraph, the term “qualified employer retirement plan” means any plan or contract described in paragraph (1), (2), or (3) of section 4974(c).

(2) **TREATMENT OF EMPLOYEE CONTRIBUTIONS UNDER DEFINED CONTRIBUTION PLANS.**—For purposes of this section, employee contributions (and any income allocable thereto) under a defined contribution plan may be treated as a separate contract.

\* \* \* \* \*

(m) **SPECIAL RULES APPLICABLE TO EMPLOYEE ANNUITIES AND DISTRIBUTIONS UNDER EMPLOYEE PLANS.**—

(2) **COMPUTATION OF CONSIDERATION PAID BY THE EMPLOYEE.**—In computing—

(A) the aggregate amount of premiums or other consideration paid for the contract for purposes of subsection (c)(1)(A) (relating to the investment in the contract), and

[(B) the consideration for the contract contributed by the employee for purposes of subsection (d)(1) (relating to employee’s contributions recoverable in 3 years) and subsection (e)(7) (relating to plans where substantially all contributions are employee contributions), and]

[(C)] (B) the aggregate premiums or other consideration paid for purposes of subsection (e)(6) (relating to certain amounts not received as an annuity), any amount allowed as a deduction with respect to the contract under section 404 which was paid while the employee was an employee within the meaning of section 401(c)(1) shall be treated as consideration contributed by the employer, and there shall not be taken into account any portion of the premiums or other consideration for the contract paid while the employee was an owner-employee which is properly allocable (as determined under regulations prescribed by the Secretary) to the cost of life, accident, health, or other insurance.

\* \* \* \* \*

(p) LOANS TREATED AS DISTRIBUTIONS.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(4) QUALIFIED EMPLOYER PLAN, ETC.— For purposes of this subsection—

(A) QUALIFIED EMPLOYER PLAN.—

(i) \* \* \*

[(ii) SPECIAL RULES.—The term “qualified employer plan”—

[(I) shall include any plan which was (or was determined to be) a qualified employer plan or a government plan, but

[(II) shall not include a plan described in subsection (e)(7).]

(ii) SPECIAL RULE.—*The term “qualified employer plan” shall not include any plan which was (or was determined to be) a qualified employer plan or a government plan.*

\* \* \* \* \*

(t) 10-PERCENT ADDITIONAL TAX ON EARLY DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.—

(1) \* \* \*

\* \* \* \* \*

(6) SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.—*In the case of any amount received from a simple retirement account (within the meaning of section 408(p)) during the 2-year period beginning on the date such individual first participated in any qualified salary reduction arrangement maintained by the individual’s employer under section 408(p)(2), paragraph (1) shall be applied by substituting “25 percent” for “10 percent”.*

\* \* \* \* \*

**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 **[adusted]** *adjusted* gross income—

(A) determined without regard to this section and sections 135, 137, 911, 931, and 933, and

(B) increased by the amount of interest received or accrued by the taxpayer during the taxable year which is exempt from tax.

\* \* \* \* \*

### PART III—ITEMS SPECIFICALLY EXCLUDED IN GROSS INCOME

Sec. 101. Certain death benefits.

\* \* \* \* \*

Sec. 112. Certain **[combat pay]** *combat zone compensation* of members of the armed forces.

\* \* \* \* \*

**[Sec. 133. Interest on certain loans used to acquire employer securities.]**

\* \* \* \* \*

#### SEC. 101. CERTAIN DEATH BENEFITS.

(a) \* \* \*

**[(b) EMPLOYEES’ DEATH BENEFITS.—**

**[(1) GENERAL RULE.—**Gross income does not include amounts received (whether in a single sum or otherwise) by the beneficiaries or the estate of an employee, if such amounts are paid by or on behalf of an employer and are paid by reason of the death of the employee.

**[(2) SPECIAL RULES FOR PARAGRAPH (1).—**

**[(A) \$5,000 LIMITATION.—**The aggregate amounts excludable under paragraph (1) with respect to the death of any employee shall not exceed \$5,000.

**[(B) NONFORFEITABLE RIGHTS.—**Paragraph (1) shall not apply to amounts with respect to which the employee possessed, immediately before his death, a nonforfeitable right to receive the amounts while living. This subparagraph shall not apply to a lump sum distribution (as defined in section 402(e)(4))—

**[(i)** by a stock bonus, pension, or profit-sharing trust described in section 401(a) which is exempt from tax under section 501(a),

**[(ii)** under an annuity contract under a plan described in section 403(a), or

**[(iii)** under an annuity contract purchased by an employer which is an organization referred to in section 170(b)(1)(A) (ii) or (vi) or which is a religious organization (other than a trust) and which is exempt from tax under section 501(a), but only with respect to that portion of such total distributions payable which bears the same ratio to the amount of such total distributions payable which is (without regard to this subsection) includible in gross income, as the amounts contributed by the employer for such annuity contract

which are excludable from gross income under section 403(b) bear to the total amounts contributed by the employer for such annuity contract.

[(C) JOINT AND SURVIVOR ANNUITIES.—Paragraph (1) shall not apply to amounts received by a surviving annuitant under a joint and survivor's annuity contract after the first day of the first period for which an amount was received as an annuity by the employee (or would have been received if the employee had lived).

[(D) OTHER ANNUITIES.—In the case of any amount to which section 72 (relating to annuities, etc.) applies, the amount which is excludable under paragraph (1) (as modified by the preceding subparagraphs of this paragraph) shall be determined by reference to the value of such amount as of the day on which the employee died. Any amount so excludable under paragraph (1) shall, for purposes of section 72, be treated as additional consideration paid by the employee. Paragraph (1) shall not apply in the case of an annuity under chapter 73 of title 10 of the United States Code if the member or former member of the uniformed services by reason of whose death such annuity is payable died after attaining retirement age.

[(3) TREATMENT OF SELF-EMPLOYED INDIVIDUALS.—For purposes of this subsection—

[(A) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED EMPLOYEE.—Except as provided in subparagraph (B), the term “employee” does not include a self-employed individual described in section 401(c)(1).

[(B) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—In the case of any amount paid or distributed—

[(i) by a trust described in section 401(a) which is exempt from tax under section 501(a), or

[(ii) under a plan described in section 403(a), the term “employee” includes a self-employed individual described in section 401(c)(1).]

(c) INTEREST.—If any amount excluded from gross income by [subsection (a) or (b)] *subsection (a)* is held under an agreement to pay interest thereon, the interest payments shall be included in gross income.

\* \* \* \* \*

#### SEC. 104. COMPENSATION FOR INJURIES OR SICKNESS.

(a) IN GENERAL.—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

[(2) the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness;]

(2) *the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump*

*sums or as periodic payments) on account of personal physical injuries or physical sickness;*

(3) \* \* \*

\* \* \* \* \*

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c)(1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee. [Paragraph (2) shall not apply to any punitive damages in connection with a case not involving physical injury or physical sickness.] *For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness. The preceding sentence shall not apply to an amount of damages not in excess of the amount paid for medical care (described in subparagraph (A) or (B) of section 213(d)(1)) attributable to emotional distress.*

\* \* \* \* \*

(c) *RESTRICTION ON PUNITIVE DAMAGES NOT TO APPLY IN CERTAIN CASES.—The restriction on the application of subsection (a)(2) to punitive damages shall not apply to punitive damages awarded in a civil action—*

*(1) which is a wrongful death action, and*

*(2) with respect to which applicable State law (as in effect on September 13, 1995 and without regard to any modification after such date) provides, or has been construed to provide by a court of competent jurisdiction pursuant to a decision issued on or before September 13, 1995, that only punitive damages may be awarded in such an action.*

*This subsection shall cease to apply to any civil action filed on or after the first date on which the applicable State law ceases to provide (or is no longer construed to provide) the treatment described in paragraph (2).*

**[(c)] (d) CROSS REFERENCES.—**

**(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.**

**(2) For exclusion of part of disability retirement pay from the application of subsection (a)(4) of this section, see section 1403 of title 10, United States Code (relating to career compensation laws).**

\* \* \* \* \*

## **SEC. 108. INCOME FROM DISCHARGE OF INDEBTEDNESS.**

(a) \* \* \*

\* \* \* \* \*

(d) **MEANING OF TERMS; SPECIAL RULES RELATING TO CERTAIN PROVISIONS.—**

(1) \* \* \*

\* \* \* \* \*

(9) **TIME FOR MAKING ELECTION, ETC.—**

(A) TIME.—An election under paragraph (5) of subsection (b) or under ~~paragraph (3)(B)~~ *paragraph (3)(C)* of subsection (c) shall be made on the taxpayer's return for the taxable year in which the discharge occurs or at such other time as may be permitted in regulations prescribed by the Secretary.

\* \* \* \* \*

**SEC. 112. CERTAIN ~~[COMBAT PAY]~~ COMBAT ZONE COMPENSATION OF MEMBERS OF THE ARMED FORCES.**

(a) \* \* \*

\* \* \* \* \*

**SEC. 117. QUALIFIED SCHOLARSHIPS.**

(a) \* \* \*

\* \* \* \* \*

(d) QUALIFIED TUITION REDUCTION.—

(1) \* \* \*

(2) QUALIFIED TUITION REDUCTION.—For purposes of this subsection, the term “qualified tuition reduction” means the amount of any reduction in tuition provided to an employee of an organization described in section 170(b)(1)(A)(ii) for the education (below the graduate level) at such organization (or another organization described in section 170(b)(1)(A)(ii)) of—

(A) such employee, or

(B) any person treated as an employee (or whose use is treated as an employee use) under the rules of ~~section 132(f)~~ *section 132(h)*.

\* \* \* \* \*

**SEC. 127. EDUCATIONAL ASSISTANCE PROGRAMS.**

(a) \* \* \*

\* \* \* \* \*

(c) DEFINITIONS; SPECIAL RULES.—For purposes of this section—

(1) EDUCATIONAL ASSISTANCE.—The term “educational assistance” means—

(A) the payment, by an employer, of expenses incurred by or on behalf of an employee for education of the employee (including, but not limited to, tuition, fees, and similar payments, books, supplies, and equipment), and

(B) the provision, by an employer, of courses of instruction for such employee (including books, supplies, and equipment), but does not include payment for, or the provision of, tools or supplies which may be retained by the employee after completion of a course of instruction, or meals, lodging, or transportation. The term “educational assistance” also does not include any payment for, or the provision of any benefits with respect to, any course or other education involving sports, games, or hobbies *or at the graduate level*.

\* \* \* \* \*

(d) **TERMINATION.**—This section shall not apply to taxable years beginning after **December 31, 1994** *December 31, 1996*.

\* \* \* \* \*

**SEC. 129. DEPENDENT CARE ASSISTANCE PROGRAMS.**

(a) \* \* \*

\* \* \* \* \*

(d) **DEPENDENT CARE ASSISTANCE PROGRAM.**—

(1) \* \* \*

\* \* \* \* \*

(8) **BENEFITS.**—

(A) \* \* \*

(B) **SALARY REDUCTION AGREEMENTS.**—For purposes of subparagraph (A), in the case of any benefits provided through a salary reduction agreement, a plan may disregard any employees whose compensation is less than \$25,000. For purposes of this subparagraph, the term “compensation” has the meaning given such term by **section 414(q)(7)** *section 414(q)(4)*, except that, under rules prescribed by the Secretary, an employer may elect to determine compensation on any other basis which does not discriminate in favor of highly compensated employees.

\* \* \* \* \*

**[SEC. 133. INTEREST ON CERTAIN LOANS USED TO ACQUIRE EMPLOYER SECURITIES.**

**[(a) IN GENERAL.**—Gross income does not include 50 percent of the interest received by—

**[(1) a bank (within the meaning of section 581),**

**[(2) an insurance company to which subchapter L applies,**

**[(3) a corporation actively engaged in the business of lending money, or**

**[(4) a regulated investment company (as defined in section 851),**

with respect to a securities acquisition loan.

**[(b) SECURITIES ACQUISITION LOAN.**—

**[(1) IN GENERAL.**—For purposes of this section, the term “securities acquisition loan” means—

**[(A) any loan to a corporation or to an employee stock ownership plan to the extent that the proceeds are used to acquire employer securities for the plan, or**

**[(B) any loan to a corporation to the extent that, within 30 days, employer securities are transferred to the plan in an amount equal to the proceeds of such loan and such securities are allocable to accounts of plan participants within 1 year of the date of such loan.**

For purposes of this paragraph, the term “employer securities” has the meaning given such term by section 409(l). The term “securities acquisition loan” shall not include a loan with a term greater than 15 years.

**[(2) LOANS BETWEEN RELATED PERSONS.**—The term “securities acquisition loan” shall not include—



[(A) any loan made between corporations which are members of the same controlled group of corporations, or

[(B) any loan made between an employee stock ownership plan and any person that is—

[(i) the employer of any employees who are covered by the plan; or

[(ii) a member of a controlled group of corporations which includes such employer.

For purposes of this paragraph, subparagraphs (A) and (B) shall not apply to any loan which, but for such subparagraphs, would be a securities acquisition loan if such loan was not originated by the employer of any employees who are covered by the plan or by any member of the controlled group of corporations which includes such employer, except that this section shall not apply to any interest received on such loan during such time as such loan is held by such employer (or any member of such controlled group).

[(3) TERMS APPLICABLE TO CERTAIN SECURITIES ACQUISITION LOANS.—A loan to a corporation shall not fail to be treated as a securities acquisition loan merely because the proceeds of such loan are lent to an employee stock ownership plan sponsored by such corporation (or by any member of the controlled group of corporations which includes such corporation) if such loan includes—

[(A) repayment terms which are substantially similar to the terms of the loan of such corporation from a lender described in subsection (a), or

[(B) repayment terms providing for more rapid repayment of principal or interest on such loan, but only if allocations under the plan attributable to such repayment do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

[(4) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this paragraph, the term “controlled group of corporations” has the meaning given such term by section 409(l)(4).

[(5) TREATMENT OF REFINANCINGS.—The term “securities acquisition loan” shall include any loan which—

[(A) is (or is part of a series of loans) used to refinance a loan described in subparagraph (A) or (B) of paragraph (1), and

[(B) meets the requirements of paragraphs (2) and (3).

[(6) PLAN MUST HOLD MORE THAN 50 PERCENT OF STOCK AFTER ACQUISITION OR TRANSFER.—

[(A) IN GENERAL.—A loan shall not be treated as a securities acquisition loan for purposes of this section unless, immediately after the acquisition or transfer referred to in subparagraph (A) or (B) of paragraph (1), respectively, the employee stock ownership plan owns more than 50 percent of—

[(i) each class of outstanding stock of the corporation issuing the employer securities, or

[(ii) the total value of all outstanding stock of the corporation.

[(B) FAILURE TO RETAIN MINIMUM STOCK INTEREST.—

[(i) IN GENERAL.—Subsection (a) shall not apply to any interest received with respect to a securities acquisition loan which is allocable to any period during which the employee stock ownership plan does not own stock meeting the requirements of subparagraph (A).

[(ii) EXCEPTION.—To the extent provided by the Secretary, clause (i) shall not apply to any period if, within 90 days of the first date on which the failure occurred (or such longer period not in excess of 180 days as the Secretary may prescribe), the plan acquires stock which results in its meeting the requirements of subparagraph (A).

[(C) STOCK.—For purposes of subparagraph (A)—

[(i) IN GENERAL.—The term “stock” means stock other than stock described in section 1504(a)(4).

[(ii) TREATMENT OF CERTAIN RIGHTS.—The Secretary may provide that warrants, options, contracts to acquire stock, convertible debt interests and other similar interests be treated as stock for 1 or more purposes under subparagraph (A).

[(D) AGGREGATION RULE.—For purposes of determining whether the requirements of subparagraph (A) are met, an employee stock ownership plan shall be treated as owning stock in the corporation issuing the employer securities which is held by any other employee stock ownership plan which is maintained by—

[(i) the employer maintaining the plan, or

[(ii) any member of a controlled group of corporations (within the meaning of section 409(l)(4)) of which the employer described in clause (i) is a member.

[(7) VOTING RIGHTS OF EMPLOYER SECURITIES.—A loan shall not be treated as a securities acquisition loan for purposes of this section unless—

[(A) the employee stock ownership plan meets the requirements of section 409(e)(2) with respect to all employer securities acquired by, or transferred to, the plan in connection with such loan (without regard to whether or not the employer has a registration-type class of securities), and

[(B) no stock described in section 409(l)(3) is acquired by, or transferred to, the plan in connection with such loan unless—

[(i) such stock has voting rights equivalent to the stock to which it may be converted, and

[(ii) the requirements of subparagraph (A) are met with respect to such voting rights.

[(c) EMPLOYEE STOCK OWNERSHIP PLAN.—For purposes of this section, the term “employee stock ownership plan” has the meaning given to such term by section 4975(e)(7).

[(d) APPLICATION WITH SECTION 483 and Original Issue Discount Rules.—In applying section 483 and subpart A of part V of subchapter P to any obligation to which this section applies, appro-

priate adjustments shall be made to the applicable Federal rate to take into account the exclusion under subsection (a).

**[(e) PERIOD TO WHICH INTEREST EXCLUSION APPLIES.—**

**[(1) IN GENERAL.—In the case of—**

**[(A) an original securities acquisition loan, and**

**[(B) any securities acquisition loan (or series of such loans) used to refinance the original securities acquisition loan, subsection (a) shall apply only to interest accruing during the excludable period with respect to the original securities acquisition loan.**

**[(2) EXCLUDABLE PERIOD.—For purposes of this subsection, the term “excludable period” means, with respect to any original securities acquisition loan—**

**[(A) IN GENERAL.—The 7-year period beginning on the date of such loan.**

**[(B) LOANS DESCRIBED IN SUBSECTION (b)(1)(A).—If the term of an original securities acquisition loan described in subsection (b)(1)(A) is greater than 7 years, the term of such loan. This subparagraph shall not apply to a loan described in subsection (b)(3)(B).**

**[(3) ORIGINAL SECURITIES ACQUISITION LOAN.—For the purposes of this subsection, the term “original securities acquisition loan” means a securities acquisition loan described in subparagraph (A) or (B) of subsection (b)(1).]**

\* \* \* \* \*

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

(a) \* \* \*

(b) LIMITATIONS.—

(1) \* \* \*

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

(A) \* \* \*

(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1990, the \$40,000 and \$60,000 amounts contained in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the taxable year begins, *determined by substituting “calendar year 1989” for “calendar year 1992” in subparagraph (B) thereof.*

\* \* \* \* \*

**PART IV—TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS**

\* \* \* \* \*

**Subpart A—Private Activity Bonds**

\* \* \* \* \*

**SEC. 143. MORTGAGE REVENUE BONDS: QUALIFIED MORTGAGE BOND  
AND QUALIFIED VETERANS' MORTGAGE BOND.**

(a) \* \* \*

\* \* \* \* \*

(d) 3-YEAR REQUIREMENT.—

(1) \* \* \*

(2) EXCEPTIONS.—For purposes of paragraph (1), the proceeds of an issue which are used to provide—

(A) financing with respect to targeted area residences,

(B) qualified home improvement loans and qualified rehabilitation loans, and

(C) financing with respect to land described in subsection (i)(1)(C) and the construction of any residence thereon[.],

shall be treated as used as described in paragraph (1).

\* \* \* \* \*

(m) RECAPTURE OF PORTION OF FEDERAL SUBSIDY FROM USE OF QUALIFIED MORTGAGE BONDS AND MORTGAGE CREDIT CERTIFICATES.—

(1) \* \* \*

\* \* \* \* \*

(4) RECAPTURE AMOUNT.—For purposes of this subsection—

(A) \* \* \*

\* \* \* \* \*

(C) HOLDING PERIOD PERCENTAGE.—

(i) \* \* \*

(ii) RETIREMENTS OF INDEBTEDNESS.—If the federally-subsidized indebtedness is completely repaid during [any month of the 10-year period] *any year of the 4-year period* beginning on the testing date, the holding period percentage for [succeeding months] *succeeding years* shall be determined by reducing ratably [over the remainder of such period (or, if lesser, 5 years)] *to zero over the succeeding 5 years* the holding period percentage which would have been determined under this subparagraph had the taxpayer disposed of his interest in the residence on the date of the repayment.

\* \* \* \* \*

**SEC. 149. BONDS MUST BE REGISTERED TO BE TAX EXEMPT; OTHER REQUIREMENTS.**

(a) \* \* \*

\* \* \* \* \*

(g) TREATMENT OF HEDGE BONDS.—

(1) \* \* \*

\* \* \* \* \*

(3) HEDGE BOND.—

(A) \* \* \*

(B) EXCEPTION FOR INVESTMENT IN TAX-EXEMPT BONDS NOT SUBJECT TO MINIMUM TAX.—

(i) \* \* \*

\* \* \* \* \*

[(iii) INVESTMENT EARNINGS HELD PENDING REINVESTMENT.—Investment earnings held for not more than 30 days pending reinvestment shall be treated as invested in bonds described in clause (i).]

(iii) AMOUNTS HELD PENDING REINVESTMENT OR REDEMPTION.—Amounts held for not more than 30 days pending reinvestment or bond redemption shall be treated as invested in bonds described in clause (i).

\* \* \* \* \*

## PART V—DEDUCTIONS FOR PERSONAL EXEMPTIONS

\* \* \* \* \*

### SEC. 151. ALLOWANCE OF DEDUCTIONS FOR PERSONAL EXEMPTIONS.

(a) \* \* \*

\* \* \* \* \*

(d) EXEMPTION AMOUNT.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) PHASEOUT.—

(A) \* \* \*

\* \* \* \* \*

(C) THRESHOLD AMOUNT.—For purposes of this paragraph, the term “threshold amount” means—

(i) \$150,000 in the case of a [joint of a return] *joint return* or a surviving spouse (as defined in section 2(a)),

\* \* \* \* \*

## PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

\* \* \* \* \*

### SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) \* \* \*

\* \* \* \* \*

(k) STOCK [REDEMPTION] REACQUISITION EXPENSES.—

(1) IN GENERAL.—Except as provided in paragraph (2), no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred by a corporation in connection with [the redemption of its stock] *the reacquisition of its stock or of the stock of any related person (as defined in section 465(b)(3)(C))*.

(2) EXCEPTIONS.—Paragraph (1) shall not apply to—

(A) CERTAIN SPECIFIC DEDUCTIONS.—Any—

(i) deduction allowable under section 163 (relating to interest), [or]

(ii) *deduction for amounts which are properly allocable to indebtedness and amortized over the term of such indebtedness, or*

[(ii)] (iii) deduction for dividends paid (within the meaning of section 561).

(B) STOCK OF CERTAIN REGULATED INVESTMENT COMPANIES.—Any amount paid or incurred in connection with the redemption of any stock in a regulated investment company which issues only stock which is redeemable upon the demand of the shareholder.

\* \* \* \* \*

#### SEC. 163. INTEREST.

(a) \* \* \*

\* \* \* \* \*

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

(1) LIMITATION.—

(A) \* \* \*

(B) DISALLOWED AMOUNT CARRIED TO SUCCEEDING TAXABLE YEAR.—Any amount disallowed under subparagraph (A) for any taxable year shall be treated as disqualified interest paid or accrued in the succeeding taxable year *(and clause (ii) of paragraph (2)(A) shall not apply for purposes of applying this subsection to the amount so treated)*.

\* \* \* \* \*

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

(A) \* \* \*

\* \* \* \* \*

(E) GROSS BASIS AND NET BASIS TAXATION.—

(i) GROSS BASIS TAX.—The term “gross basis tax” means any tax imposed by this subtitle which is determined by reference to the gross amount of any item of income without any reduction for any deduction allowed by this subtitle.

(ii) NET BASIS TAX.—The term “net basis tax” means any tax imposed by this subtitle which is [a] not a gross basis tax.

(7) COORDINATION WITH PASSIVE LOSS RULES, ETC.—*This subsection shall be applied before sections 465 and 469.*

[(7)] (8) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this subsection, including—

(A) such regulations as may be appropriate to prevent the avoidance of the purposes of this subsection,

\* \* \* \* \*

#### SEC. 164. TAXES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

- (2) State and local personal property taxes.
- (3) State and local, and foreign, income, war profits, and excess profits taxes.
- [(4) The environmental tax imposed by section 59A.
- [(5) The GST tax imposed on income distributions.]]
- (4) *The GST tax imposed on income distributions.*
- (5) *The environmental tax imposed by section 59A.*

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for production of income). Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

\* \* \* \* \*

#### SEC. 167. DEPRECIATION.

(a) \* \* \*

\* \* \* \* \*

(g) *DEPRECIATION UNDER INCOME FORECAST METHOD.*—

(1) *IN GENERAL.*—*If the depreciation deduction allowable under this section to any taxpayer with respect to any property is determined under the income forecast method or any similar method—*

*(A) the income from the property to be taken into account in determining the depreciation deduction under such method shall be equal to the amount of income earned in connection with the property before the close of the 10th taxable year following the taxable year in which the property was placed in service,*

*(B) the adjusted basis of the property shall only include amounts with respect to which the requirements of section 461(h) are satisfied,*

*(C) the depreciation deduction under such method for the 10th taxable year beginning after the taxable year in which the property was placed in service shall be equal to the adjusted basis of such property as of the beginning of such 10th taxable year, and*

*(D) such taxpayer shall pay (or be entitled to receive) interest computed under the look-back method of paragraph (2) for any recomputation year.*

(2) *LOOK-BACK METHOD.*—*The interest computed under the look-back method of this paragraph for any recomputation year shall be determined by—*

*(A) first determining the depreciation deductions under this section with respect to such property which would have been allowable for prior taxable years if the determination of the amounts so allowable had been made on the basis of the sum of the following (instead of the estimated income from such property)—*

(i) the actual income earned in connection with such property for periods before the close of the recomputation year, and

(ii) an estimate of the future income to be earned in connection with such property for periods after the recomputation year and before the close of the 10th taxable year following the taxable year in which the property was placed in service,

(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each such prior taxable year which would result solely from the application of subparagraph (A), and

(C) then using the adjusted overpayment rate (as defined in section 460(b)(7)), compounded daily, on the overpayment or underpayment determined under subparagraph (B).

For purposes of the preceding sentence, any cost incurred after the property is placed in service (which is not treated as a separate property under paragraph (5)) shall be taken into account by discounting (using the Federal mid-term rate determined under section 1274(d) as of the time such cost is incurred) such cost to its value as of the date the property is placed in service. The taxpayer may elect with respect to any property to have the preceding sentence not apply to such property.

(3) *EXCEPTION FROM LOOK-BACK METHOD.*—Paragraph (1)(D) shall not apply with respect to any property which, when placed in service by the taxpayer, had a basis of \$100,000 or less.

(4) *RECOMPUTATION YEAR.*—For purposes of this subsection, except as provided in regulations, the term “recomputation year” means, with respect to any property, the 3d and the 10th taxable years beginning after the taxable year in which the property was placed in service, unless the actual income earned in connection with the property for the period before the close of such 3d or 10th taxable year is within 10 percent of the income earned in connection with the property for such period which was taken into account under paragraph (1)(A).

(5) *SPECIAL RULES.*—

(A) *CERTAIN COSTS TREATED AS SEPARATE PROPERTY.*—For purposes of this subsection, the following costs shall be treated as separate properties:

(i) Any costs incurred with respect to any property after the 10th taxable year beginning after the taxable year in which the property was placed in service.

(ii) Any costs incurred after the property is placed in service and before the close of such 10th taxable year if such costs are significant and give rise to a significant increase in the income from the property which was not included in the estimated income from the property.

(B) *SYNDICATION INCOME FROM TELEVISION SERIES.*—In the case of property which is an episode in a television series, income from syndicating such series shall not be required to be taken into account under this subsection before the earlier of—



- (i) the 4th taxable year beginning after the date the first episode in such series is placed in service, or
- (ii) the earliest taxable year in which the taxpayer has an arrangement relating to the future syndication of such series.

(C) *SPECIAL RULES FOR FINANCIAL EXPLOITATION OF CHARACTERS, ETC.*—For purposes of this subsection, in the case of television and motion picture films, the income from the property shall include income from the exploitation of characters, designs, scripts, scores, and other incidental income associated with such films, but only to the extent that such income is earned in connection with the ultimate use of such items by, or the ultimate sale of merchandise to, persons who are not related persons (within the meaning of section 267(b)) to the taxpayer.

(D) *COLLECTION OF INTEREST.*—For purposes of subtitle F (other than sections 6654 and 6655), any interest required to be paid by the taxpayer under paragraph (1) for any recomputation year shall be treated as an increase in the tax imposed by this chapter for such year.

(E) *DETERMINATIONS.*—For purposes of paragraph (2), determinations of the amount of income earned in connection with any property shall be made in the same manner as for purposes of applying the income forecast method; except that any income from the disposition of such property shall be taken into account.

(F) *TREATMENT OF PASS-THRU ENTITIES.*—Rules similar to the rules of section 460(b)(4) shall apply for purposes of this subsection.

[(g)] (h) **CROSS REFERENCES.**—

(1) \* \* \*

\* \* \* \* \*

**SEC. 168. ACCELERATED COST RECOVERY SYSTEM.**

(a) \* \* \*

\* \* \* \* \*

(e) **CLASSIFICATION OF PROPERTY.**—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) **CLASSIFICATION OF CERTAIN PROPERTY.**—

(A) \* \* \*

(B) **5-YEAR PROPERTY.**—The term “5-year property” includes—

- (i) any automobile or light general purpose truck,
- (ii) any semi-conductor manufacturing equipment,
- (iii) any computer-based telephone central office switching equipment,
- (iv) any qualified technological equipment,
- (v) any section 1245 property used in connection with research and experimentation, and
- (vi) any property which—

(I) is described in subparagraph (A) of section 48(a)(3) (or would be so described if “solar and

wind” were substituted for “solar” in clause (i) thereof, **[or]**

(II) is described in paragraph (15) of section 48(l) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990) and is a qualifying small power production facility within the meaning of section 3(17)(C) of the Federal Power Act (16 U.S.C. 796(17)(C)), as in effect on September 1, 1986**[.]**, or

*(III) is described in section 48(l)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990).*

*Nothing in any provision of law shall be construed to treat property as not being described in clause (vi)(I) (or the corresponding provisions of prior law) by reason of being public utility property (within the meaning of section 48(a)(3)).*

\* \* \* \* \*

(g) **ALTERNATIVE DEPRECIATION SYSTEM FOR CERTAIN PROPERTY**  
(1) \* \* \*

\* \* \* \* \*

(4) **EXCEPTION FOR CERTAIN PROPERTY USED OUTSIDE UNITED STATES.**—Subparagraph (A) of paragraph (1) shall not apply to—

(A) \* \* \*

\* \* \* \* \*

(K) any property described in **[section 48(a)(3)(A)(iii)]** *section 48(l)(3)(A)(ix) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990)* which is owned by a United States person and which is used in international or territorial waters to generate energy for use in the United States; and

\* \* \* \* \*

**SEC. 172. NET OPERATING LOSS DEDUCTION.**

(a) \* \* \*

(b) **NET OPERATING LOSS CARRYBACKS AND CARRYOVERS.**—

(1) **YEARS TO WHICH LOSS MAY BE CARRIED.**—

(A) \* \* \*

\* \* \* \* \*

(E) **EXCESS INTEREST LOSS.**—

(i) \* \* \*

(ii) **LOSS LIMITATION YEAR.**—For purposes of clause (i) and **[subsection (m)]** *subsection (h)*, the term “loss limitation year” means, with respect to any corporate equity reduction transaction, the taxable year in which such transaction occurs and each of the 2 succeeding taxable years.

\* \* \* \* \*

(h) **CORPORATE EQUITY REDUCTION INTEREST LOSSES.**—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) CORPORATE EQUITY REDUCTION TRANSACTION.—

(A) \* \* \*

(B) MAJOR STOCK ACQUISITION.—

(i) IN GENERAL.—The term “major stock acquisition” means the acquisition by a corporation pursuant to a plan of such corporation (or any group of persons acting in concert with such corporation) of stock in another corporation representing 50 percent or more (by vote or value) of the stock in such other corporation~~[,]~~.

\* \* \* \* \*

(4) OTHER RULES.—

(A) \* \* \*

(B) COORDINATION WITH SUBSECTION (b)(2).—~~For purposes of subsection (b)(2)—~~ *For purposes of subsection (b)(2)—*

(i) a corporate equity reduction interest loss shall be treated in a manner similar to the manner in which a specified liability loss is treated, and

(ii) in determining the net operating loss deduction for any prior taxable year referred to in the 3rd sentence of subsection (b)(2), the portion of any net operating loss which may not be carried to such taxable year under subsection (b)(1)(E) shall not be taken into account.

(C) MEMBERS OF AFFILIATED GROUPS.—Except as provided by regulations, all members of an affiliated group filing a consolidated return under section 1501 shall be treated as 1 taxpayer for purposes of this subsection and ~~[subsection (b)(1)(M)] subsection (b)(1)(E)~~.

\* \* \* \* \*

#### SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) \* \* \*

(b) LIMITATIONS.—

**[(1) DOLLAR LIMITATION.—**The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed \$17,500.**]**

*(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed the following applicable amount:*

<i>If the taxable year begins in:</i>	<i>The applicable amount is:</i>
1996 .....	\$18,500
1997 .....	19,000
1998 .....	20,000
1999 .....	21,000
2000 .....	22,000
2001 .....	23,000

2002 .....	23,500
2003 or thereafter .....	25,000.
* * * * *	

(d) DEFINITIONS AND SPECIAL RULES.—

(1) SECTION 179 PROPERTY.—For purposes of this section, the term “section 179 property” means any tangible property (to which section 168 applies) which is section 1245 property (as defined in section 1245(a)(3)) and which is acquired by purchase for use in the active conduct of **[in a trade or business]** *a trade or business. Such term shall not include any property described in section 50(b) and shall not include air conditioning or heating units and horses.*

\* \* \* \* \*

**SEC. 179A. DEDUCTION FOR CLEAN-FUEL VEHICLES AND CERTAIN RE-FUELING PROPERTY.**

(a) \* \* \*

\* \* \* \* \*

**[(g)] (f) TERMINATION.**—This section shall not apply to any property placed in service after December 31, 2004.

\* \* \* \* \*

**PART VII—ADDITIONAL ITEMIZED DEDUCTIONS FOR INDIVIDUALS**

\* \* \* \* \*

**SEC. 219. RETIREMENT SAVINGS.**

(a) \* \* \*

(b) MAXIMUM AMOUNT OF DEDUCTION.—

(1) \* \* \*

\* \* \* \* \*

(4) *SPECIAL RULE FOR SIMPLE RETIREMENT ACCOUNTS.*—*This section shall not apply with respect to any amount contributed to a simple retirement account established under section 408(p).*

\* \* \* \* \*

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

(1) \* \* \*

\* \* \* \* \*

(5) ACTIVE PARTICIPANT.—For purposes of this subsection, the term “active participant” means, with respect to any plan year, an individual—

(A) who is an active participant in—

(i) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(ii) an annuity plan described in section 403(a),

(iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

(iv) an annuity contract described in section 403(b), or

(v) a simplified employee pension (within the meaning of section 408(k)), **or**

(vi) any simple retirement account (within the meaning of section 408(p)), or

\* \* \* \* \*

## PART VIII—SPECIAL DEDUCTIONS FOR CORPORATIONS

\* \* \* \* \*

### SEC. 243. DIVIDENDS RECEIVED BY CORPORATIONS.

(a) \* \* \*

(b) QUALIFYING DIVIDENDS.—

(1) \* \* \*

**[(2) AFFILIATED GROUP.—For purposes of this subsection, the term “affiliated group” has the meaning given such term by section 1504(a), except that for such purposes sections 1504(b)(2), 1504(b)(4), and 1504(c) shall not apply.]**

**(2) AFFILIATED GROUP.—For purposes of this subsection:**

**(A) IN GENERAL.—The term “affiliated group” has the meaning given such term by section 1504(a), except that for such purposes sections 1504(b)(2), 1504(b)(4), and 1504(c) shall not apply.**

**(B) GROUP MUST BE CONSISTENT IN FOREIGN TAX TREATMENT.—The requirements of paragraph (1)(A) shall not be treated as being met with respect to any dividend received by a corporation if, for any taxable year which includes the day on which such dividend is received—**

**(i) 1 or more members of the affiliated group referred to in paragraph (1)(A) choose to any extent to take the benefits of section 901, and**

**(ii) 1 or more other members of such group claim to any extent a deduction for taxes otherwise creditable under section 901.**

\* \* \* \* \*

**(3) SPECIAL RULE FOR GROUPS WHICH INCLUDE LIFE INSURANCE COMPANIES.—**

**(A) IN GENERAL.—In the case of an affiliated group which includes 1 or more insurance companies under section 801, no dividend by any member of such group shall be treated as a qualifying dividend unless an election under this paragraph is in effect for the taxable year in which the dividend is received. The preceding sentence shall not apply in the case of a dividend described in paragraph (1)(B)(ii).**

\* \* \* \* \*

## PART IX—ITEMS NOT DEDUCTIBLE

\* \* \* \* \*

**SEC. 280A. DISALLOWANCE OF CERTAIN EXPENSES IN CONNECTION WITH BUSINESS USE OF HOME, RENTAL OF VACATION HOMES, ETC.**

(a) \* \* \*

\* \* \* \* \*

(c) EXCEPTIONS FOR CERTAIN BUSINESS OR RENTAL USE; LIMITATION ON DEDUCTIONS FOR SUCH USE.—

(1) CERTAIN BUSINESS USE.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

[(A) the principal place of business for any trade or business of the taxpayer.]

*(A) as the principal place of business for any trade or business of the taxpayer.*

\* \* \* \* \*

(2) CERTAIN STORAGE USE.—Subsection (a) shall not apply to any item to the extent such item is allocable to space within the dwelling unit which is used on a regular basis as a storage unit for the [inventory] *inventory or product samples* of the taxpayer held for use in the taxpayer's trade or business of selling products at retail or wholesale, but only if the dwelling unit is the sole fixed location of such trade or business.

\* \* \* \* \*

**SEC. 280F. LIMITATION ON DEPRECIATION FOR LUXURY AUTOMOBILES; LIMITATION WHERE CERTAIN PROPERTY USED FOR PERSONAL PURPOSES.**

(a) LIMITATION ON AMOUNT OF [INVESTMENT TAX CREDIT AND] DEPRECIATION FOR LUXURY AUTOMOBILES.—

(1) \* \* \*

\* \* \* \* \*

**SEC. 280G. GOLDEN PARACHUTE PAYMENTS.**

(a) \* \* \*

(b) EXCESS PARACHUTE PAYMENT.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(6) EXEMPTION FOR PAYMENTS UNDER QUALIFIED PLANS.—Notwithstanding paragraph (2), the term “parachute payment” shall not include any payment to or from—

(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(B) an annuity plan described in section 403(a), [or]

(C) a simplified employee pension (as defined in section 408(k))**[I.]**, or

*(D) a simple retirement account described in section 408(p).*

\* \* \* \* \*

**PART XI—SPECIAL RULES RELATING TO CORPORATE PREFERENCE ITEMS**

\* \* \* \* \*

**SEC. 291. SPECIAL RULES RELATING TO CORPORATE PREFERENCE ITEMS.**

(a) \* \* \*

\* \* \* \* \*

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

(1) FINANCIAL INSTITUTION PREFERENCE ITEM.—The term “financial institution preference item” includes the following:

(B) INTEREST ON DEBT TO CARRY TAX-EXEMPT OBLIGATIONS ACQUIRED AFTER DECEMBER 31, 1982, AND BEFORE AUGUST 8, 1986.—

(i) \* \* \*

\* \* \* \* \*

[(iv) SPECIAL RULES FOR OBLIGATIONS TO WHICH SECTION 133 APPLIES.—In the case of an obligation to which section 133 applies, interest on such obligation shall not be treated as exempt from taxes for purposes of this subparagraph.]

[(v)] (iv) APPLICATION OF SUBPARAGRAPH TO CERTAIN OBLIGATIONS ISSUED AFTER AUGUST 7, 1986.—For application of this subparagraph to certain obligations issued after August 7, 1986, see section 265(b)(3).

\* \* \* \* \*

## **SUBCHAPTER C—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS**

\* \* \* \* \*

### **PART II—CORPORATE LIQUIDATIONS**

\* \* \* \* \*

#### **Subpart C—Collapsible Corporations**

\* \* \* \* \*

**SEC. 341. COLLAPSIBLE CORPORATIONS.**

(a) \* \* \*

\* \* \* \* \*

(f) CERTAIN SALES OF STOCK OF CONSENTING CORPORATIONS.—

(1) \* \* \*

\* \* \* \* \*

(3) EXCEPTION FOR CERTAIN TAX-FREE TRANSACTIONS.—If the basis of a subsection (f) asset in the hands of a transferee is determined by reference to its basis in the hands of the transferor by reason of the application of section 332, [351, 361, 371(a), or 374(a)] 351, or 361, then the amount of gain taken into account by the transferor under paragraph (2) shall not exceed the amount of gain recognized to the transferor on the transfer of such asset (determined without regard to this subsection). This paragraph shall apply only if the transferee—

(A) is not an organization which is exempt from tax imposed by this chapter, and

(B) agrees (at such time and in such manner as the Secretary may by regulations prescribe) to have the provisions of paragraph (2) apply to any disposition by it of such subsection (f) asset.

\* \* \* \* \*

### **PART III—CORPORATE ORGANIZATIONS AND REORGANIZATIONS**

\* \* \* \* \*

#### **Subpart A—Corporate Organization**

\* \* \* \* \*

#### **SEC. 355. DISTRIBUTION OF STOCK AND SECURITIES OF A CONTROLLED CORPORATION.**

(a) \* \* \*

\* \* \* \* \*

(d) RECOGNITION OF GAIN ON CERTAIN DISTRIBUTIONS OF STOCK OR SECURITIES IN CONTROLLED CORPORATION.—

(1) \* \* \*

\* \* \* \* \*

(7) AGGREGATION RULES.—

(A) IN GENERAL.—For purposes of this subsection, a person and all persons related to such person (within the meaning of *section* 267(b) or 707(b)(1)) shall be treated as one person.

\* \* \* \* \*

### **Subchapter D—Deferred Compensation, Etc.**

\* \* \* \* \*

### **PART I—PENSION, PROFIT-SHARING, STOCK BONUS PLANS, ETC.**

\* \* \* \* \*

#### **Subpart A—General Rule**

\* \* \* \* \*

#### **SEC. 401. QUALIFIED PENSION, PROFIT-SHARING, AND STOCK BONUS PLANS.**

(a) REQUIREMENTS FOR QUALIFICATION.—A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section—

(1) \* \* \*

\* \* \* \* \*

(5) SPECIAL RULES RELATING TO NONDISCRIMINATION REQUIREMENTS.—



(A) \* \* \*

\* \* \* \* \*

(D) INTEGRATED DEFINED BENEFIT PLAN.—

(i) \* \* \*

(ii) FINAL PAY.—For purposes of this subparagraph, the participant's final pay is the compensation (as defined in section ~~414(q)(7)~~ 414(q)(4)) paid to the participant by the employer for any year—

(I) which ends during the 5-year period ending with the year in which the participant separated from service for the employer, and

(II) for which the participant's total compensation from the employer was highest.

\* \* \* \* \*

(F) SOCIAL SECURITY RETIREMENT AGE.—*For purposes of testing for discrimination under paragraph (4)—*

*(i) the social security retirement age (as defined in section 415(b)(8)) shall be treated as a uniform retirement age, and*

*(ii) subsidized early retirement benefits and joint and survivor annuities shall not be treated as being unavailable to employees on the same terms merely because such benefits or annuities are based in whole or in part on an employee's social security retirement age (as so defined).*

\* \* \* \* \*

(9) REQUIRED DISTRIBUTIONS.—

(A) \* \* \*

\* \* \* \* \*

[(C) REQUIRED BEGINNING DATE.—For purposes of this paragraph, the term “required beginning date” means April 1 of the calendar year following the calendar year in which the employee attains age 70-1/2. In the case of a governmental plan or church plan, the required beginning date shall be the later of the date determined under the preceding sentence or April 1 of the calendar year following the calendar year in which the employee retires. For purposes of this subparagraph, the term “church plan” means a plan maintained by a church for church employees, and the term “church” means any church (as defined in section 3121(w)(3)(A)) or qualified church controlled organization (as defined in section 3121(w)(3)(B)).]

(C) REQUIRED BEGINNING DATE.—*For purposes of this paragraph—*

*(i) IN GENERAL.—The term “required beginning date” means April 1 of the calendar year following the later of—*

*(I) the calendar year in which the employee attains age 70½, or*

*(II) the calendar year in which the employee retires.*

(ii) *EXCEPTION.*—Subclause (II) of clause (i) shall not apply—

(I) except as provided in section 409(d), in the case of an employee who is a 5-percent owner (as defined in section 416) with respect to the plan year ending in the calendar year in which the employee attains age 70½, or

(II) for purposes of section 408 (a)(6) or (b)(3).

(iii) *ACTUARIAL ADJUSTMENT.*—In the case of an employee to whom clause (i)(II) applies who retires in a calendar year after the calendar year in which the employee attains age 70½, the employee's accrued benefit shall be actuarially increased to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

(iv) *EXCEPTION FOR GOVERNMENTAL AND CHURCH PLANS.*—Clauses (ii) and (iii) shall not apply in the case of a governmental plan or church plan. For purposes of this clause, the term “church plan” means a plan maintained by a church for church employees, and the term “church” means any church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

\* \* \* \* \*

(17) *COMPENSATION LIMIT.*—

(A) *IN GENERAL.*—A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed \$150,000. [In determining the compensation of an employee, the rules of section 414(q)(6) shall apply, except that in applying such rules, the term “family” shall include only the spouse of the employee and any lineal descendants of the employee who have not attained age 19 before the close of the year.]

\* \* \* \* \*

(20) A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section merely because the pension plan of which such trust is a part makes 1 or more distributions within 1 taxable year to a distributee on account of a termination of the plan of which the trust is a part, or in the case of a profit-sharing or stock bonus plan, a complete discontinuance of contributions under such plan. This paragraph shall not apply to a defined benefit plan unless the employer maintaining such plan files a notice with the Pension Benefit Guaranty Corporation (at the time and in the manner prescribed by the Pension Benefit Guaranty Corporation) notifying the Corporation of such payment or distribution and the Corporation has approved such payment or distribution or, within 90 days after the date on which such notice was filed, has failed to disapprove such payment or distribution. For purposes of this paragraph, rules similar to the rules of section 402(a)(6)(B) (as in effect before its repeal by

section [211] 521 of the Unemployment Compensation Amendments of 1992) shall apply.

\* \* \* \* \*

(26) ADDITIONAL PARTICIPATION REQUIREMENTS.—

[(A) IN GENERAL.—A trust shall not constitute a qualified trust under this subsection unless such trust is part of a plan which on each day of the plan year benefits the lesser of—

[(i) 50 employees of the employer, or

[(ii) 40 percent or more of all employees of the employer.]

(A) *IN GENERAL.—In the case of a trust which is a part of a defined benefit plan, such trust shall not constitute a qualified trust under this subsection unless on each day of the plan year such trust benefits at least the lesser of—*

*(i) 50 employees of the employer, or*

*(ii) the greater of—*

*(I) 40 percent of all employees of the employer, or*

*(II) 2 employees (or if there is only 1 employee, such employee).*

\* \* \* \* \*

(G) SEPARATE LINES OF BUSINESS.—At the election of the employer and with the consent of the Secretary, this paragraph may be applied separately with respect to each separate line of business of the employer. For purposes of this paragraph, the term “separate line of business” has the meaning given such term by section 414(r) (without regard to [paragraph (7)] *paragraph (2)(A) or (7) thereof*).

\* \* \* \* \*

(28) ADDITIONAL REQUIREMENTS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS.—

(A) \* \* \*

(B) DIVERSIFICATION OF INVESTMENTS.—

(i) \* \* \*

\* \* \* \* \*

[(v) COORDINATION WITH DISTRIBUTION RULES.—Any distribution required by this subparagraph shall not be taken into account in determining whether a subsequent distribution is a lump sum distribution under section 402(d)(4)(A) or in determining whether section 402(c)(10) applies.]

\* \* \* \* \*

[(d) ADDITIONAL REQUIREMENTS FOR QUALIFICATION OF TRUSTS AND PLANS BENEFITING OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the following requirements of this subsection are met by the trust and by the plan of which such trust is a part:

[(1)(A) If the plan provides contributions or benefits for an owner-employee who controls, or for two or more owner-employees who together control, the trade or business with respect to which the plan is established, and who also control as an owner-employee or as owner-employees one or more other trades or businesses, such plan and the plans established with respect to such other trades or businesses, when coalesced, constitute a single plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection with respect to the employees of all such trades or businesses (including the trade or business with respect to which the plan intended to qualify under this section is established).

[(B) For purposes of subparagraph (A), an owner-employee, or two or more owner-employees, shall be considered to control a trade or business if such owner-employee, or such two or more owner-employees together—

[(i) own the entire interest in an unincorporated trade or business, or

[(ii) in the case of a partnership, own more than 50 percent of either the capital interest or the profits interest in such partnership.

For purposes of the preceding sentence, an owner-employee, or two or more owner-employees, shall be treated as owning any interest in a partnership which is owned, directly or indirectly, by a partnership which such owner-employee, or such two or more owner-employees, are considered to control within the meaning of the preceding sentence.

[(2) The plan does not provide contributions or benefits for any owner-employee who controls (within the meaning of paragraph (1)(B)), or for two or more owner-employees who together control, as an owner-employee or as owner-employees, any other trade or business, unless the employees of each trade or business which such owner-employee or such owner-employees control are included under a plan which meets the requirements of subsection (a) (including paragraph (10) thereof) and of this subsection, and provides contributions and benefits for employees which are not less favorable than contributions and benefits provided for owner-employees under the plan.

[(3) Under the plan, contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.]

*(d) CONTRIBUTION LIMIT ON OWNER-EMPLOYEES.—A trust forming part of a pension or profit-sharing plan which provides contributions or benefits for employees some or all of whom are owner-employees shall constitute a qualified trust under this section only if, in addition to meeting the requirements of subsection (a), the plan provides that contributions on behalf of any owner-employee may be made only with respect to the earned income of such owner-employee which is derived from the trade or business with respect to which such plan is established.*

\* \* \* \* \*

(k) CASH OR DEFERRED ARRANGEMENTS.—

(1) \* \* \*

\* \* \* \* \*

(3) APPLICATION OF PARTICIPATION AND DISCRIMINATION STANDARDS.—

(A) A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement unless—

(i) those employees eligible to benefit under the arrangement satisfy the provisions of section 410(b)(1), and

(ii) the actual deferral percentage for eligible highly compensated employees (as defined in paragraph (5)) for [such year] *the plan year* bears a relationship to the actual deferral percentage for all other eligible employees [for such plan year] *for the preceding plan year* which meets either of the following tests:

(I) The actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 1.25.

(II) The excess of the actual deferral percentage for the group of eligible highly compensated employees over that of all other eligible employees is not more than 2 percentage points, and the actual deferral percentage for the group of eligible highly compensated employees is not more than the actual deferral percentage of all other eligible employees multiplied by 2.

If 2 or more plans which include cash or deferred arrangements are considered as 1 plan for purposes of section 401(a)(4) or 410(b), the cash or deferred arrangements included in such plans shall be treated as 1 arrangement for purposes of this subparagraph. *An arrangement may apply this clause by using the plan year rather than the preceding plan year if the employer so elects, except that if such an election is made, it may not be changed except as provided by the Secretary.*

If any highly compensated employee is a participant under 2 or more cash or deferred arrangements of the employer, for purposes of determining the deferral percentage with respect to such employee, all such cash or deferred arrangements shall be treated as 1 cash or deferred arrangement.

\* \* \* \* \*

(E) *For purposes of this paragraph, in the case of the first plan year of any plan (other than a successor plan), the amount taken into account as the actual deferral percentage of nonhighly compensated employees for the preceding plan year shall be—*

(i) 3 percent, or

(ii) *if the employer makes an election under this subclause, the actual deferral percentage of nonhighly*

*compensated employees determined for such first plan year.*

\* \* \* \* \*

(4) OTHER REQUIREMENTS.—  
(A) \* \* \*

[(B) STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS NOT ELIGIBLE.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by—

[(i) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

[(ii) any organization exempt from tax under this subtitle.

This subparagraph shall not apply to a rural cooperative plan.]

(B) *ELIGIBILITY OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.*—

(i) *TAX-EXEMPTS ELIGIBLE.*—*Except as provided in clause (ii), any organization exempt from tax under this subtitle may include a qualified cash or deferred arrangement as part of a plan maintained by it.*

(ii) *GOVERNMENTS INELIGIBLE.*—*A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof. This clause shall not apply to a rural cooperative plan or to a plan of an employer described in clause (iii).*

(iii) *TREATMENT OF INDIAN TRIBAL GOVERNMENTS.*—*An employer which is an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency or instrumentality of an Indian tribal government or subdivision thereof, or a corporation chartered under Federal, State, or tribal law which is owned in whole or in part by any of the foregoing shall be treated as an organization exempt from tax under this subtitle for purposes of clause (i).*

\* \* \* \* \*

(7) RURAL COOPERATIVE PLAN.—For purposes of this subsection—

(A) \* \* \*

(B) RURAL COOPERATIVE DEFINED.—For purposes of subparagraph (A), the term “rural cooperative” means—

[(i) any organization which—

[(I) is exempt from tax under this subtitle or which is a State or local government or political subdivision thereof (or agency or instrumentality thereof), and

[(II) is engaged primarily in providing electric service on a mutual or cooperative basis,]

(i) any organization which—

(I) is engaged primarily in providing electric service on a mutual or cooperative basis, or

(II) is engaged primarily in providing electric service to the public in its area of service and which is exempt from tax under this subtitle or which is a State or local government (or an agency or instrumentality thereof), other than a municipality (or an agency or instrumentality thereof),

\* \* \* \* \*

(C) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—A rural cooperative plan which includes a qualified cash or deferred arrangement shall not be treated as violating the requirements of section 401(a) or of paragraph (2) merely by reason of a hardship distribution or a distribution to a participant after attainment of age 59½. For purposes of this section, the term “hardship distribution” means a distribution described in paragraph (2)(B)(i)(IV) (without regard to the limitation of its application to profit-sharing or stock bonus plans).

(8) ARRANGEMENT NOT DISQUALIFIED IF EXCESS CONTRIBUTIONS DISTRIBUTED.—

(A) \* \* \*

\* \* \* \* \*

(C) METHOD OF DISTRIBUTING EXCESS CONTRIBUTIONS.—

Any distribution of the excess contributions for any plan year shall be made to highly compensated employees [on the basis of the respective portions of the excess contributions attributable to each of such employees] on the basis of the amount of contributions by, or on behalf of, each of such employees.

\* \* \* \* \*

(10) DISTRIBUTIONS UPON TERMINATION OF PLAN OR DISPOSITION OF ASSETS OR SUBSIDIARY.—

(A) \* \* \*

(B) DISTRIBUTIONS MUST BE LUMP SUM DISTRIBUTIONS.—

(i) IN GENERAL.—An event shall not be treated as described in subparagraph (A) with respect to any employee unless the employee receives a lump sum distribution by reason of the event.

[(ii) LUMP SUM DISTRIBUTION.—For purposes of this subparagraph, the term “lump sum distribution” has the meaning given such term by section 402(d)(4), without regard to clauses (i), (ii), (iii), and (iv) of subparagraph (A), subparagraph (B), or subparagraph (F) thereof.]

(ii) LUMP-SUM DISTRIBUTION.—For purposes of this subparagraph, the term “lump-sum distribution” has the meaning given such term by section 402(e)(4)(D) (without regard to subclauses (I), (II), (III), and (IV) of clause (i) thereof).

\* \* \* \* \*

(11) ADOPTION OF SIMPLE PLAN TO MEET NONDISCRIMINATION TESTS.—

(A) *IN GENERAL.*—A cash or deferred arrangement maintained by an eligible employer shall be treated as meeting the requirements of paragraph (3)(A)(ii) if such arrangement meets—

- (i) the contribution requirements of subparagraph (B),
- (ii) the exclusive benefit requirements of subparagraph (C), and
- (iii) the vesting requirements of section 408(p)(3).

(B) CONTRIBUTION REQUIREMENTS.—

(i) *IN GENERAL.*—The requirements of this subparagraph are met if, under the arrangement—

(I) an employee may elect to have the employer make elective contributions for the year on behalf of the employee to a trust under the plan in an amount which is expressed as a percentage of compensation of the employee but which in no event exceeds \$6,000,

(II) the employer is required to make a matching contribution to the trust for the year in an amount equal to so much of the amount the employee elects under subclause (I) as does not exceed 3 percent of compensation for the year, and

(III) no other contributions may be made other than contributions described in subclause (I) or (II).

(ii) *EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.*—An employer shall be treated as meeting the requirements of clause (i)(II) for any year if, in lieu of the contributions described in such clause, the employer elects (pursuant to the terms of the arrangement) to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least \$5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 30th day before the beginning of such year.

(C) *EXCLUSIVE BENEFIT.*—The requirements of this subparagraph are met for any year to which this paragraph applies if no contributions were made, or benefits were accrued, for services during such year under any qualified plan of the employer on behalf of any employee eligible to participate in the cash or deferred arrangement, other than contributions described in subparagraph (B).

(D) DEFINITIONS AND SPECIAL RULE.—

(i) *DEFINITIONS.*—For purposes of this paragraph, any term used in this paragraph which is also used in section 408(p) shall have the meaning given such term by such section.



(ii) *COORDINATION WITH TOP-HEAVY RULES.*—A plan meeting the requirements of this paragraph for any year shall not be treated as a top-heavy plan under section 416 for such year.

(12) *ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.*—

(A) *IN GENERAL.*—A cash or deferred arrangement shall be treated as meeting the requirements of paragraph

(3)(A)(ii) if such arrangement—

(i) meets the contribution requirements of subparagraph (B) or (C), and

(ii) meets the notice requirements of subparagraph (D).

(B) *MATCHING CONTRIBUTIONS.*—

(i) *IN GENERAL.*—The requirements of this subparagraph are met if, under the arrangement, the employer makes matching contributions on behalf of each employee who is not a highly compensated employee in an amount equal to—

(I) 100 percent of the elective contributions of the employee to the extent such elective contributions do not exceed 3 percent of the employee's compensation, and

(II) 50 percent of the elective contributions of the employee to the extent that such elective contributions exceed 3 percent but do not exceed 5 percent of the employee's compensation.

(ii) *RATE FOR HIGHLY COMPENSATED EMPLOYEES.*—The requirements of this subparagraph are not met if, under the arrangement, the rate of matching contribution with respect to any elective contribution of a highly compensated employee at any rate of elective contribution is greater than that with respect to an employee who is not a highly compensated employee.

(iii) *ALTERNATIVE PLAN DESIGNS.*—If the rate of any matching contribution with respect to any rate of elective contribution is not equal to the percentage required under clause (i), an arrangement shall not be treated as failing to meet the requirements of clause (i) if—

(I) the rate of an employer's matching contribution does not increase as an employee's rate of elective contributions increase, and

(II) the aggregate amount of matching contributions at such rate of elective contribution is at least equal to the aggregate amount of matching contributions which would be made if matching contributions were made on the basis of the percentages described in clause (i).

(C) *NONELECTIVE CONTRIBUTIONS.*—The requirements of this subparagraph are met if, under the arrangement, the employer is required, without regard to whether the employee makes an elective contribution or employee contribution, to make a contribution to a defined contribution plan on behalf of each employee who is not a highly com-

pensated employee and who is eligible to participate in the arrangement in an amount equal to at least 3 percent of the employee's compensation.

(D) *NOTICE REQUIREMENT.*—An arrangement meets the requirements of this paragraph if, under the arrangement, each employee eligible to participate is, within a reasonable period before any year, given written notice of the employee's rights and obligations under the arrangement which—

(i) is sufficiently accurate and comprehensive to appraise the employee of such rights and obligations, and

(ii) is written in a manner calculated to be understood by the average employee eligible to participate.

(E) *OTHER REQUIREMENTS.*—

(i) *WITHDRAWAL AND VESTING RESTRICTIONS.*—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) of this paragraph unless the requirements of subparagraphs (B) and (C) of paragraph (2) are met with respect to all employer contributions (including matching contributions) taken into account in determining whether the requirements of subparagraphs (B) and (C) of this paragraph are met.

(ii) *SOCIAL SECURITY AND SIMILAR CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.*—An arrangement shall not be treated as meeting the requirements of subparagraph (B) or (C) unless such requirements are met without regard to subsection (l), and, for purposes of subsection (l), employer contributions under subparagraph (B) or (C) shall not be taken into account.

(F) *OTHER PLANS.*—An arrangement shall be treated as meeting the requirements under subparagraph (A)(i) if any other plan maintained by the employer meets such requirements with respect to employees eligible under the arrangement.

\* \* \* \* \*

(m) *NONDISCRIMINATION TEST FOR MATCHING CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS.*—

(1) \* \* \*

(2) *REQUIREMENTS.*—

(A) *CONTRIBUTION PERCENTAGE REQUIREMENT.*—A plan meets the contribution percentage requirement of this paragraph for any plan year only if the contribution percentage for eligible highly compensated employees *for such plan year* does not exceed the greater of—

(i) 125 percent of such percentage for all other eligible employees *for the preceding plan year*, or

(ii) the lesser of 200 percent of such percentage for all other eligible employees *for the preceding plan year*, or such percentage for all other eligible employees *for the preceding plan year* plus 2 percentage points.

*This subparagraph may be applied by using the plan year rather than the preceding plan year if the employer so*

*elects, except that if such an election is made, it may not be changed except as provided the Secretary.*

\* \* \* \* \*

(3) CONTRIBUTION PERCENTAGE.—For purposes of paragraph (2), the contribution percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

(A) the sum of the matching contributions and employee contributions paid under the plan on behalf of each such employee for such plan year, to

(B) the employee's compensation (within the meaning of section 414(s)) for such plan year.

Under regulations, an employer may elect to take into account (in computing the contribution percentage) elective deferrals and qualified nonelective contributions under the plan or any other plan of the employer. If matching contributions are taken into account for purposes of subsection (k)(3)(A)(ii) for any plan year, such contributions shall not be taken into account under subparagraph (A) for such year. *Rules similar to the rules of subsection (k)(3)(E) shall apply for purposes of this subsection.*

\* \* \* \* \*

(6) PLAN NOT DISQUALIFIED IF EXCESS AGGREGATE CONTRIBUTIONS DISTRIBUTED BEFORE END OF FOLLOWING PLAN YEAR.—

(A) \* \* \*

\* \* \* \* \*

(C) METHOD OF DISTRIBUTING EXCESS AGGREGATE CONTRIBUTIONS.—Any distribution of the excess aggregate contributions for any plan year shall be made to highly compensated employees [on the basis of the respective portions of such amounts attributable to each of such employees] *on the basis of the amount of contributions on behalf of, or by, each such employee.* Forfeitures of excess aggregate contributions may not be allocated to participants whose contributions are reduced under this paragraph.

\* \* \* \* \*

(10) ALTERNATIVE METHOD OF SATISFYING TESTS.—*A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—*

(A) *meets the contribution requirements of subparagraph*

(B) *of subsection (k)(11),*

(B) *meets the exclusive benefit requirements of subsection (k)(11)(C), and*

(C) *meets the vesting requirements of section 408(p)(3).*

(11) ALTERNATIVE METHOD OF SATISFYING TESTS.—

(A) *IN GENERAL.—A defined contribution plan shall be treated as meeting the requirements of paragraph (2) with respect to matching contributions if the plan—*

(i) *meets the contribution requirements of subparagraph (B) or (C) of subsection (k)(12),*

(ii) *meets the notice requirements of subsection (k)(12)(D), and*

(iii) meets the requirements of subparagraph (B).

(B) **LIMITATION ON MATCHING CONTRIBUTIONS.**—The requirements of this subparagraph are met if—

(i) matching contributions on behalf of any employee may not be made with respect to an employee's contributions or elective deferrals in excess of 6 percent of the employee's compensation,

(ii) the rate of an employer's matching contribution does not increase as the rate of an employee's contributions or elective deferrals increase, and

(iii) the matching contribution with respect to any highly compensated employee at any rate of an employee contribution or rate of elective deferral is not greater than that with respect to an employee who is not a highly compensated employee.

[(10)] (12) **CROSS REFERENCE.**—

**For excise tax on certain excess contributions, see section 4979.**

\* \* \* \* \*

#### **SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.**

(a) \* \* \*

\* \* \* \* \*

(c) **RULES APPLICABLE TO ROLLOVERS FROM EXEMPT TRUSTS.**—

(1) \* \* \*

\* \* \* \* \*

[(10) **DENIAL OF AVERAGING FOR SUBSEQUENT DISTRIBUTIONS.**—If paragraph (1) applies to any distribution paid to any employee, paragraphs (1) and (3) of subsection (d) shall not apply to any distribution (paid after such distribution) of the balance to the credit of the employee under the plan under which the preceding distribution was made (or under any other plan which, under subsection (d)(4)(C), would be aggregated with such plan).]

\* \* \* \* \*

[(d) **TAX ON LUMP SUM DISTRIBUTIONS.**—

[(1) **IMPOSITION OF SEPARATE TAX ON LUMP SUM DISTRIBUTIONS.**—

[(A) **SEPARATE TAX.**—There is hereby imposed a tax (in the amount determined under subparagraph (B)) on a lump sum distribution.

[(B) **AMOUNT OF TAX.**—The amount of tax imposed by subparagraph (A) for any taxable year is an amount equal to 5 times the tax which would be imposed by subsection (c) of section 1 if the recipient were an individual referred to in such subsection and the taxable income were an amount equal to  $\frac{1}{5}$  of the excess of—

[(i) the total taxable amount of the lump sum distribution for the taxable year, over

[(ii) the minimum distribution allowance.

[(C) **MINIMUM DISTRIBUTION ALLOWANCE.**—For purposes of this paragraph, the minimum distribution allowance for any taxable year is an amount equal to—

[(i) the lesser of \$10,000 or one-half of the total taxable amount of the lump sum distribution for the taxable year, reduced (but not below zero) by

[(ii) 20 percent of the amount (if any) by which such total taxable amount exceeds \$20,000.

[(D) LIABILITY FOR TAX.—The recipient shall be liable for the tax imposed by this paragraph.

[(2) DISTRIBUTIONS OF ANNUITY CONTRACTS.—

[(A) IN GENERAL.—In the case of any recipient of a lump sum distribution for any taxable year, if the distribution (or any part thereof) is an annuity contract, the total taxable amount of the distribution shall be aggregated for purposes of computing the tax imposed by paragraph (1)(A), except that the amount of tax so computed shall be reduced (but not below zero) by that portion of the tax on the aggregate total taxable amount which is attributable to annuity contracts.

[(B) BENEFICIARIES.—For purposes of this paragraph, a beneficiary of a trust to which a lump sum distribution is made shall be treated as the recipient of such distribution if the beneficiary is an employee (including an employee within the meaning of section 401(c)(1)) with respect to the plan under which the distribution is made or if the beneficiary is treated as the owner of such trust for purposes of subpart E of part I of subchapter J.

[(C) ANNUITY CONTRACTS.—For purposes of this paragraph, in the case of the distribution of an annuity contract, the taxable amount of such distribution shall be deemed to be the current actuarial value of the contract, determined on the date of such distribution.

[(D) TRUSTS.—In the case of a lump sum distribution with respect to any individual which is made only to 2 or more trusts, the tax imposed by paragraph (1)(A) shall be computed as if such distribution was made to a single trust, but the liability for such tax shall be apportioned among such trusts according to the relative amounts received by each.

[(E) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this paragraph.

[(3) ALLOWANCE OF DEDUCTION.—The total taxable amount of a lump sum distribution for any taxable year shall be allowed as a deduction from gross income for such taxable year, but only to the extent included in the taxpayer's gross income for such taxable year.

[(4) DEFINITIONS AND SPECIAL RULES.—

[(A) LUMP SUM DISTRIBUTION.—For purposes of this section and section 403, the term "lump sum distribution" means the distribution or payment within 1 taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

[(i) on account of the employee's death,

[(ii) after the employee attains age 59½,

[(iii) on account of the employee's separation from the service, or

[(iv) after the employee has become disabled (within the meaning of section 72(m)(7)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Clause (iii) of this subparagraph shall be applied only with respect to an 401(c)(1), and clause (iv) shall be applied only with respect to an employee within the meaning of section 401(c)(1). A distribution of an annuity contract from a trust or annuity plan referred to in the first sentence of this subparagraph shall be treated as a lump sum distribution. For purposes of this subparagraph, a distribution to 2 or more trusts shall be treated as a distribution to 1 recipient. For purposes of this subsection, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

[(B) AVERAGING TO APPLY TO 1 LUMP SUM DISTRIBUTION AFTER AGE 59½.—Paragraph (1) shall apply to a lump sum distribution with respect to an employee under subparagraph (A) only if—

[(i) such amount is received on or after the date on which the employee has attained age 59½, and

[(ii) the taxpayer elects for the taxable year to have all such amounts received during such taxable year so treated.

Not more than 1 election may be made under this subparagraph by any taxpayer with respect to any employee. No election may be made under this subparagraph by any taxpayer other than an individual, an estate, or a trust. In the case of a lump sum distribution made with respect to an employee to 2 or more trusts, the election under this subparagraph shall be made by the personal representative of the taxpayer.

[(C) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under subparagraph (A)—

[(i) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

[(ii) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

[(D) TOTAL TAXABLE AMOUNT.—For purposes of this section and section 403, the term “total taxable amount” means, with respect to a lump sum distribution, the amount of such distribution which exceeds the sum of—

[(i) the amounts considered contributed by the employee (determined by applying section 72(f)), reduced by any amounts previously distributed which were not includible in gross income, and

[(ii) the net unrealized appreciation attributable to that part of the distribution which consists of the securities of the employer corporation so distributed.

[(E) COMMUNITY PROPERTY LAWS.—The provisions of this subsection, other than paragraph (3), shall be applied without regard to community property laws.

[(F) MINIMUM PERIOD OF SERVICE.—For purposes of this subsection, no amount distributed to an employee from or under a plan may be treated as a lump sum distribution under subparagraph (A) unless the employee has been a participant in the plan for 5 or more taxable years before the taxable year in which such amounts are distributed.

[(G) AMOUNTS SUBJECT TO PENALTY.—This subsection shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

[(H) BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.—For purpose of this subsection, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

[(I) TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.—For purposes of this subsection, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

[(J) LUMP SUM DISTRIBUTIONS OF ALTERNATE PAYEES.—If any distribution or payment of the balance to the credit of an employee would be treated as a lump sum distribution, then, for purposes of this subsection, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump sum distribution. For purposes of this subparagraph, the balance to the credit of the alternate payee shall not include any amount payable to the employee.

[(K) TREATMENT OF PORTION NOT ROLLED OVER.—If any portion of a lump sum distribution is transferred in a transfer to which subsection (c) applies, paragraphs (1) and (3) shall not apply with respect to the distribution.

[(L) SECURITIES.—For purposes of this subsection, the terms “securities” and “securities of the employer corporation” have the respective meanings provided by subsection (e)(4)(E).

[(5) SPECIAL RULE WHERE PORTIONS OF LUMP SUM DISTRIBUTION ATTRIBUTABLE TO ROLLOVER OF BOND PURCHASED UNDER

QUALIFIED BOND PURCHASE PLAN.—If any portion of a lump sum distribution is attributable to a transfer described in section 405(d)(3)(A)(ii) (as in effect before its repeal by the Tax Reform Act of 1984), paragraphs (1) and (3) of this subsection shall not apply to such portion.

[(6) TREATMENT OF POTENTIAL FUTURE VESTING.—

[(A) IN GENERAL.—For purposes of determining whether any distribution which becomes payable to the recipient on account of the employee's separation from service is a lump sum distribution, the balance to the credit of the employee shall be determined without regard to any increase in vesting which may occur if the employee is reemployed by the employer.

[(B) RECAPTURE IN CERTAIN CASES.—If—

[(i) an amount is treated as a lump sum distribution by reason of subparagraph (A),

[(ii) special lump sum treatment applies to such distribution,

[(iii) the employee is subsequently reemployed by the employer, and

[(iv) as a result of services performed after being so reemployed, there is an increase in the employee's vesting for benefits accrued before the separation referred to in subparagraph (A),

under regulations prescribed by the Secretary, the tax imposed by this chapter for the taxable year (in which the increase in vesting first occurs) shall be increased by the reduction in tax which resulted from the special lump treatment (and any election under paragraph 4(B) shall not be taken into account for purposes of determining whether the employee may make another election under paragraph (4)(B)).

[(C) SPECIAL LUMP SUM TREATMENT.—For purposes of this paragraph, special lump treatment applies to any distribution if any portion of such distribution is taxed under the subsection by reason of any election under paragraph (4)(B).

[(D) VESTING.—For purposes of this paragraph, the term “vesting” means the portion of the accrued benefits derived from employer contributions to which the participant has a nonforfeitable right.

[(7) COORDINATION WITH FOREIGN TAX CREDIT LIMITATIONS.—Subsections (a), (b), and (c) of section 904 shall be applied separately with respect to any lump sum distribution on which tax is imposed under paragraph (1), and the amount of such distribution shall be treated as the taxable income for purposes of such separate application.]

(d) *TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUS TRUSTS.*—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).

(e) *OTHER RULES APPLICABLE TO EXEMPT TRUSTS.*—



(1) \* \* \*

\* \* \* \* \*

(4) NET UNREALIZED APPRECIATION.—  
(A) \* \* \*

\* \* \* \* \*

[(D) LUMP SUM DISTRIBUTION.—For purposes of this paragraph, the term “lump sum distribution” has the meaning given such term by subsection (d)(4)(A) (without regard to subsection (d)(4)(F)).]

(D) LUMP-SUM DISTRIBUTION.—For purposes of this paragraph—

(i) IN GENERAL.—The term “lump sum distribution” means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient—

(I) on account of the employee’s death,

(II) after the employee attains age 59½,

(III) on account of the employee’s separation from service, or

(IV) after the employee has become disabled (within the meaning of section 72(m)(7)),

from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a). Subclause (III) of this clause shall be applied only with respect to an individual who is an employee without regard to section 401(c)(1), and subclause (IV) shall be applied only with respect to an employee within the meaning of section 401(c)(1). For purposes of this clause, a distribution to two or more trusts shall be treated as a distribution to one recipient. For purposes of this paragraph, the balance to the credit of the employee does not include the accumulated deductible employee contributions under the plan (within the meaning of section 72(o)(5)).

(ii) AGGREGATION OF CERTAIN TRUSTS AND PLANS.—For purposes of determining the balance to the credit of an employee under clause (i)—

(I) all trusts which are part of a plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan, and

(II) trusts which are not qualified trusts under section 401(a) and annuity contracts which do not satisfy the requirements of section 404(a)(2) shall not be taken into account.

(iii) COMMUNITY PROPERTY LAWS.—The provisions of this paragraph shall be applied without regard to community property laws.

(iv) *AMOUNTS SUBJECT TO PENALTY.*—This paragraph shall not apply to amounts described in subparagraph (A) of section 72(m)(5) to the extent that section 72(m)(5) applies to such amounts.

(v) *BALANCE TO CREDIT OF EMPLOYEE NOT TO INCLUDE AMOUNTS PAYABLE UNDER QUALIFIED DOMESTIC RELATIONS ORDER.*—For purposes of this paragraph, the balance to the credit of an employee shall not include any amount payable to an alternate payee under a qualified domestic relations order (within the meaning of section 414(p)).

(vi) *TRANSFERS TO COST-OF-LIVING ARRANGEMENT NOT TREATED AS DISTRIBUTION.*—For purposes of this paragraph, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan.

(vii) *LUMP-SUM DISTRIBUTIONS OF ALTERNATE PAYEES.*—If any distribution or payment of the balance to the credit of an employee would be treated as a lump-sum distribution, then, for purposes of this paragraph, the payment under a qualified domestic relations order (within the meaning of section 414(p)) of the balance to the credit of an alternate payee who is the spouse or former spouse of the employee shall be treated as a lump-sum distribution. For purposes of this clause, the balance to the credit of the alternate payee shall not include any amount payable to the employee.

[(5) *TAXABILITY OF BENEFICIARY OF CERTAIN FOREIGN SITUUS TRUSTS.*—For purposes of subsections (a), (b), and (c), a stock bonus, pension, or profit-sharing trust which would qualify for exemption from tax under section 501(a) except for the fact that it is a trust created or organized outside the United States shall be treated as if it were a trust exempt from tax under section 501(a).]

\* \* \* \* \*

(g) *LIMITATION ON EXCLUSION FOR ELECTIVE DEFERRALS.*—

(1) \* \* \*

\* \* \* \* \*

(3) *ELECTIVE DEFERRALS.*—For purposes of this subsection, the term “elective deferrals” means, with respect to any taxable year, the sum of—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not includible in gross income for the taxable year under subsection [(a)(8)] (e)(3) (determined without regard to this subsection),

(B) any employer contribution to the extent not includible in gross income for the taxable year under subsection (h)(1)(B) (determined without regard to this subsection),  
[and]

(C) any employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement (within the meaning of section 3121(a)(5)(D))**[.], and**

(D) any elective employer contribution under section 408(p)(2)(A)(i).

An employer contribution shall not be treated as an elective deferral described in subparagraph (C) if under the salary reduction agreement such contribution is made pursuant to a one-time irrevocable election made by the employee at the time of initial eligibility to participate in the agreement or is made pursuant to a similar arrangement involving a one-time irrevocable election specified in regulations.

\* \* \* \* \*

(k) *TREATMENT OF SIMPLE RETIREMENT ACCOUNTS.*—Rules similar to the rules of paragraphs (1) and (3) of subsection (h) shall apply to contributions and distributions with respect to a simple retirement account under section 408(p).

#### **SEC. 403. TAXATION OF EMPLOYEE ANNUITIES.**

(a) \* \* \*

(b) **TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION OR PUBLIC SCHOOL.**—

(1) **GENERAL RULE.**—If—

(A) \* \* \*

\* \* \* \* \*

**[(E) in the case of a contract purchased under a plan which provides a salary reduction agreement, the plan meets the requirements of section 401(a)(30),]**

*(E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30),*

then amounts contributed by such employer for such annuity contract on or after such rights become nonforfeitable shall be excluded from the gross income of the employee for the taxable year to the extent that the aggregate of such amounts does not exceed the exclusion allowance for such taxable year. The amount actually distributed to any distributee under such contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities). For purposes of applying the rules of this subsection to amounts contributed by an employer for a taxable year, amounts transferred to a contract described in this paragraph by reason of a rollover contribution described in paragraph (8) of this subsection or section 408(d)(3)(A)(iii) shall not be considered contributed by such employer.

\* \* \* \* \*

(10) **DISTRIBUTION REQUIREMENTS.**—Under regulations prescribed by the Secretary, this subsection shall not apply to any annuity contract (or to any custodial account described in paragraph (7) or retirement income account described in paragraph (9)) unless requirements similar to the requirements of section 401(a)(9) and 401(a)(31) are met (and requirements similar to

the incidental death benefit requirements of section 401(a) are met) with respect to such annuity contract (or custodial account or retirement income account). Any amount transferred in **[an]** a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of the transfer.

\* \* \* \* \*

**SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED PAYMENT PLAN.**

(a) **GENERAL RULE.**—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter; but, if they would otherwise be deductible, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

(1) \* \* \*

(2) **EMPLOYEES' ANNUITIES.**—In the taxable year when paid, in an amount determined in accordance with paragraph (1), if the contributions are paid toward the purchase of retirement annuities, or retirement annuities and medical benefits as described in section 401(h), and such purchase is part of a plan which meets the requirements of section 401(a) (3), (4), (5), (6), (7), (8), (9), (11), (12), (13), (14), (15), (16), (17), **[(18),]** (19), (20), (22), (26), (27) and (31) and, if applicable, the requirements of section 401(a)(10) and of section 401(d), and if refunds of premiums, if any, are applied within the current taxable year or next succeeding taxable year toward the purchase of such retirement annuities, or such retirement annuities and medical benefits.

\* \* \* \* \*

(j) **SPECIAL RULES RELATING TO APPLICATION WITH SECTION 415.**—

(1) **NO DEDUCTION IN EXCESS OF SECTION 415 LIMITATION.**—In computing the amount of any deduction allowable under paragraph (1), (2), (3), (4), (7), or **[(10)]** (9) of subsection (a) for any year—

(A) in the case of a defined benefit plan, there shall not be taken into account any benefits for any year in excess of any limitation on such benefits under section 415 for such year, or

(B) in the case of a defined contribution plan, the amount of any contributions otherwise taken into account shall be reduced by any annual additions in excess of the limitation under section 415 for such year.

\* \* \* \* \*

(l) **LIMITATION ON AMOUNT OF ANNUAL COMPENSATION TAKEN INTO ACCOUNT.**—For purposes of applying the limitations of this section, the amount of annual compensation of each employee taken into account under the plan for any year shall not exceed

\$150,000. The Secretary shall adjust the \$150,000 amount at the same time, and by the same amount, as any adjustment under section 401(a)(17)(B). For purposes of clause (i), (ii), or (iii) of subsection (a)(1)(A), and in computing the full funding limitation, any adjustment under the preceding sentence shall not be taken into account for any year before the year for which such adjustment first takes effect. [In determining the compensation of an employee, the rules of section 414(q)(6) shall apply, except that in applying such rules, the term "family" shall include only the spouse of the employee and any lineal descendants of the employee who have not attained age 19 before the close of the year.]

(m) *SPECIAL RULES FOR SIMPLE RETIREMENT ACCOUNTS.*—

(1) *IN GENERAL.*—Employer contributions to a simple retirement account shall be treated as if they are made to a plan subject to the requirements of this section.

(2) *TIMING.*—

(A) *DEDUCTION.*—Contributions described in paragraph (1) shall be deductible in the taxable year of the employer with or within which the calendar year for which the contributions were made ends.

(B) *CONTRIBUTIONS AFTER END OF YEAR.*—For purposes of this subsection, contributions shall be treated as made for a taxable year if they are made on account of the taxable year and are made not later than the time prescribed by law for filing the return for the taxable year (including extensions thereof).

\* \* \* \* \*

#### **SEC. 406. EMPLOYEES OF FOREIGN AFFILIATES COVERED BY SECTION 3121(l) AGREEMENTS.**

(a) \* \* \*

\* \* \* \* \*

[(c) **TERMINATION OF STATUS AS DEEMED EMPLOYEE NOT TO BE TREATED AS SEPARATION FROM SERVICE FOR PURPOSES OF LIMITATION OF TAX.**—For purposes of applying section 402(d) with respect to an individual who is treated as an employee of an American employer under subsection (a), such individual shall not be considered as separated from the service of such American employer solely by reason of the fact that—

[(1) the agreement entered into by such American employer under section 3121(l) which covers the employment of such individual is terminated under the provisions of such section,

[(2) such individual becomes an employee of a foreign affiliate with respect to which such agreement does not apply,

[(3) such individual ceases to be an employee of the foreign affiliate by reason of which he is treated as an employee of such American employer, if he becomes an employee of another entity in which such American employer has not less than a 10-percent interest (within the meaning of section 3121(l)(8)(B)), or

[(4) the provision of the plan described in subsection (a)(2) is terminated.]

\* \* \* \* \*

(e) TREATMENT AS EMPLOYEE UNDER RELATED PROVISIONS.—An individual who is treated as an employee of an American employer under subsection (a) shall also be treated as an employee of such American employer, with respect to the plan described in subsection (a)(2), for purposes of applying the following provisions of this title:

(1) Section 72(f) (relating to special rules for computing employees' contributions).

[(2) Section 101(b) (relating to employees' death benefits).]

[(3)] (2) Section 2039 (relating to annuities).

\* \* \* \* \*

**SEC. 407. CERTAIN EMPLOYEES OF DOMESTIC SUBSIDIARIES ENGAGED IN BUSINESS OUTSIDE THE UNITED STATES.**

(a) \* \* \*

\* \* \* \* \*

[(c) TERMINATION OF STATUS AS DEEMED EMPLOYEE NOT TO BE TREATED AS SEPARATION FROM SERVICE FOR PURPOSES OF LIMITATIONS OF TAX.—For purposes of applying section 402(d) with respect to an individual who is treated as an employee of a domestic parent corporation under subsection (a), such individual shall not be considered as separated from the service of such domestic parent corporation solely by reason of the fact that—

[(1) the corporation of which such individual is an employee ceases, for any taxable year, to be a domestic subsidiary within the meaning of subsection (a)(2)(A),

[(2) such individual ceases to be an employee of a domestic subsidiary of such domestic parent corporation, if he becomes an employee of another corporation controlled by such domestic parent corporation, or

[(3) the provision of the plan described in subsection (a)(1)(A) is terminated.]

\* \* \* \* \*

(e) TREATMENT AS EMPLOYEE UNDER RELATED PROVISIONS.—An individual who is treated as an employee of a domestic parent corporation under subsection (a) shall also be treated as an employee of such domestic parent corporation, with respect to the plan described in subsection (a)(1)(A), for purposes of applying the following provisions of this title:

(1) Section 72(f) (relating to special rules for computing employees' contributions).

[(2) Section 101(b) (relating to employees' death benefits).]

[(3)] (2) Section 2039 (relating to annuities).

\* \* \* \* \*

**SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.**

(a) \* \* \*

\* \* \* \* \*

(d) TAX TREATMENT OF DISTRIBUTIONS.—

(1) \* \* \*

\* \* \* \* \*

(3) ROLLOVER CONTRIBUTION.—An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

(A) \* \* \*

\* \* \* \* \*

(G) SIMPLE RETIREMENT ACCOUNTS.—*This paragraph shall not apply to any amount paid or distributed out of a simple retirement account (as defined in section 408(p)) unless—*

*(i) it is paid into another simple retirement account, or*

*(ii) in the case of any payment or distribution to which section 72(t)(8) does not apply, it is paid into an individual retirement plan.*

\* \* \* \* \*

(i) REPORTS.—The trustee of an individual retirement account and the issuer of an endowment contract described in subsection (b) or an individual retirement annuity shall make such reports regarding such account, contract, or annuity to the Secretary and to the individuals for whom the account, contract, or annuity is, or is to be, maintained with respect to contributions (and the years to which they relate), distributions aggregating \$10 or more in any calendar year, and such other matters as the Secretary may require under regulations. The reports required by this subsection—

(1) shall be filed at such time and in such manner as the Secretary prescribes in such regulations, and

(2) shall be furnished to individuals—

(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(B) in such manner as the Secretary prescribes in such regulations.

*In the case of a simple retirement account under subsection (p), only one report under this subsection shall be required to be submitted each calendar year to the Secretary (at the time provided under paragraph (2)) but, in addition to the report under this subsection, there shall be furnished, within 30 days after each calendar year, to the individual on whose behalf the account is maintained a statement with respect to the account balance as of the close of, and the account activity during, such calendar year.*

\* \* \* \* \*

(k) SIMPLIFIED EMPLOYEE PENSION DEFINED.—

(1) \* \* \*

(2) PARTICIPATION REQUIREMENTS.—This paragraph is satisfied with respect to a simplified employee pension for a year only if for such year the employer contributes to the simplified employee pension of each employee who—

(A) has attained age 21,

(B) has performed service for the employer during at least 3 of the immediately preceding 5 years, and

(C) received at least \$300 in compensation (within the meaning of section [414(q)(7)] 414(q)(4)) from the employer for the year.

For purposes of this paragraph, there shall be excluded from consideration employees described in subparagraph (A) or (C) of section 410(b)(3). For purposes of any arrangement described in subsection (k)(6), any employee who is eligible to have employer contributions made on the employee's behalf under such arrangement shall be treated as if such a contribution was made.

\* \* \* \* \*

(6) EMPLOYEE MAY ELECT SALARY REDUCTION ARRANGEMENT.—

(A) \* \* \*

\* \* \* \* \*

(H) *TERMINATION.*—*This paragraph shall not apply to years beginning after December 31, 1996. The preceding sentence shall not apply to a simplified employee pension if the terms of such pension, as in effect on December 31, 1996, provide that an employee may make the election described in subparagraph (A).*

(1) SIMPLIFIED EMPLOYER REPORTS.—[An employer]

(1) *IN GENERAL.*—*An employer who makes a contribution on behalf of an employee to a simplified employee pension shall provide such simplified reports with respect to such contributions as the Secretary may require by regulations. The reports required by this subsection shall be filed at such time and in such manner, and information with respect to such contributions shall be furnished to the employee at such time and in such manner, as may be required by regulations.*

(2) SIMPLE RETIREMENT ACCOUNTS.—

(A) *NO EMPLOYER REPORTS.*—*Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a qualified salary reduction arrangement under subsection (p).*

(B) *SUMMARY DESCRIPTION.*—*The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) shall provide to the employer maintaining the arrangement, each year a description containing the following information:*

(i) *The name and address of the employer and the trustee.*

(ii) *The requirements for eligibility for participation.*

(iii) *The benefits provided with respect to the arrangement.*

(iv) *The time and method of making elections with respect to the arrangement.*

(v) *The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.*

(C) *EMPLOYEE NOTIFICATION.*—*The employer shall notify each employee immediately before the period for which an election described in subsection (p)(5)(C) may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B).*

\* \* \* \* \*



(p) *SIMPLE RETIREMENT ACCOUNTS.*—

(1) *IN GENERAL.*—For purposes of this title, the term “simple retirement account” means an individual retirement plan (as defined in section 7701(a)(37))—

(A) with respect to which the requirements of paragraphs (3), (4), and (5) are met; and

(B) with respect to which the only contributions allowed are contributions under a qualified salary reduction arrangement.

(2) *QUALIFIED SALARY REDUCTION ARRANGEMENT.*—

(A) *IN GENERAL.*—For purposes of this subsection, the term “qualified salary reduction arrangement” means a written arrangement of an eligible employer under which—

(i) an employee eligible to participate in the arrangement may elect to have the employer make payments—

(I) as elective employer contributions to a simple retirement account on behalf of the employee, or

(II) to the employee directly in cash,

(ii) the amount which an employee may elect under clause (i) for any year is required to be expressed as a percentage of compensation and may not exceed a total of \$6,000 for any year,

(iii) the employer is required to make a matching contribution to the simple retirement account for any year in an amount equal to so much of the amount the employee elects under clause (i)(I) as does not exceed the applicable percentage of compensation for the year, and

(iv) no contributions may be made other than contributions described in clause (i) or (iii).

(B) *EMPLOYER MAY ELECT 2-PERCENT NONELECTIVE CONTRIBUTION.*—An employer shall be treated as meeting the requirements of subparagraph (A)(iii) for any year if, in lieu of the contributions described in such clause, the employer elects to make nonelective contributions of 2 percent of compensation for each employee who is eligible to participate in the arrangement and who has at least \$5,000 of compensation from the employer for the year. If an employer makes an election under this subparagraph for any year, the employer shall notify employees of such election within a reasonable period of time before the 30-day period for such year under paragraph (5)(C).

(C) *DEFINITIONS.*—For purposes of this subsection—

(i) *ELIGIBLE EMPLOYER.*—The term “eligible employer” means an employer who employs 100 or fewer employees on any day during the year.

(ii) *APPLICABLE PERCENTAGE.*—

(I) *IN GENERAL.*—The term “applicable percentage” means 3 percent.

(II) *ELECTION OF LOWER PERCENTAGE.*—An employer may elect to apply a lower percentage (not less than 1 percent) for any year for all employees eligible to participate in the plan for such year if the employer notifies the employees of such lower

percentage within a reasonable period of time before the 30-day election period for such year under paragraph (5)(C). An employer may not elect a lower percentage under this subclause for any year if that election would result in the applicable percentage being lower than 3 percent in more than 2 of the years in the 5-year period ending with such year.

(III) SPECIAL RULE FOR YEARS ARRANGEMENT NOT IN EFFECT.—If any year in the 5-year period described in subclause (II) is a year prior to the first year for which any qualified salary reduction arrangement is in effect with respect to the employer (or any predecessor), the employer shall be treated as if the level of the employer matching contribution was at 3 percent of compensation for such prior year.

(D) ARRANGEMENT MAY BE ONLY PLAN OF EMPLOYER.—

(i) IN GENERAL.—An arrangement shall not be treated as a qualified salary reduction arrangement for any year if the employer (or any predecessor employer) maintained a qualified plan with respect to which contributions were made, or benefits were accrued, for service in any year in the period beginning with the year such arrangement became effective and ending with the year for which the determination is being made.

(ii) QUALIFIED PLAN.—For purposes of this subparagraph, the term “qualified plan” means a plan, contract, pension, or trust described in subparagraph (A) or (B) of section 219(g)(5).

(E) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the \$6,000 amount under subparagraph (A)(ii) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter ending September 30, 1995, and any increase under this subparagraph which is not a multiple of \$500 shall be rounded to the next lower multiple of \$500.

(3) VESTING REQUIREMENTS.—The requirements of this paragraph are met with respect to a simple retirement account if the employee’s rights to any contribution to the simple retirement account are nonforfeitable. For purposes of this paragraph, rules similar to the rules of subsection (k)(4) shall apply.

(4) PARTICIPATION REQUIREMENTS.—

(A) IN GENERAL.—The requirements of this paragraph are met with respect to any simple retirement account for a year only if, under the qualified salary reduction arrangement, all employees of the employer who—

(i) received at least \$5,000 in compensation from the employer during any 2 preceding years, and

(ii) are reasonably expected to receive at least \$5,000 in compensation during the year,

are eligible to make the election under paragraph (2)(A)(i) or receive the nonelective contribution described in paragraph (2)(B).

(B) *EXCLUDABLE EMPLOYEES.*—An employer may elect to exclude from the requirement under subparagraph (A) employees described in section 410(b)(3).

(5) *ADMINISTRATIVE REQUIREMENTS.*—The requirements of this paragraph are met with respect to any simplified retirement account if, under the qualified salary reduction arrangement—

(A) an employer must—

(i) make the elective employer contributions under paragraph (2)(A)(i) not later than the close of the 30-day period following the last day of the month with respect to which the contributions are to be made, and

(ii) make the matching contributions under paragraph (2)(A)(iii) or the nonelective contributions under paragraph (2)(B) not later than the date described in section 404(m)(2)(B),

(B) an employee may elect to terminate participation in such arrangement at any time during the year, except that if an employee so terminates, the arrangement may provide that the employee may not elect to resume participation until the beginning of the next year, and

(C) each employee eligible to participate may elect, during the 30-day period before the beginning of any year (and the 30-day period before the first day such employee is eligible to participate), to participate in the arrangement, or to modify the amounts subject to such arrangement, for such year.

(6) *DEFINITIONS.*—For purposes of this subsection—

(A) *COMPENSATION.*—

(i) *IN GENERAL.*—The term “compensation” means amounts described in paragraphs (3) and (8) of section 6051(a).

(ii) *SELF-EMPLOYED.*—In the case of an employee described in subparagraph (B), the term “compensation” means net earnings from self-employment determined under section 1402(a) without regard to any contribution under this subsection.

(B) *EMPLOYEE.*—The term “employee” includes an employee as defined in section 401(c)(1).

(C) *YEAR.*—The term “year” means the calendar year.

[(p)] (q) *CROSS REFERENCES.*—

(1) \* \* \*

\* \* \* \* \*

## Subpart B—Special Rules

\* \* \* \* \*

### SEC. 411. MINIMUM VESTING STANDARDS.

(a) *GENERAL RULE.*—A trust shall not constitute a qualified trust under section 401(a) unless the plan of which such trust is a part provides that an employee’s right to his normal retirement benefit

is nonforfeitable upon the attainment of normal retirement age (as defined in paragraph (8)) and in addition satisfies the requirements of paragraphs (1), (2), and (11) of this subsection and the requirements of subsection (b)(3), and also satisfies, in the case of a defined benefit plan, the requirements of subsection (b)(1) and, in the case of a defined contribution plan, the requirements of subsection (b)(2).

(1) \* \* \*

(2) EMPLOYER CONTRIBUTIONS.—A plan satisfies the requirements of this paragraph if it satisfies the requirements of [subparagraph (A), (B), or (C)] *subparagraph (A) or (B)*.

(A) 5-YEAR VESTING.—A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

\* \* \* \* \*

[(C) MULTIEMPLOYER PLANS.—A plan satisfies the requirements of this subparagraph if—

[(i) the plan is a multiemployer plan (within the meaning of section 414(f)), and

[(ii) under the plan—

[(I) an employee who is covered pursuant to a collective bargaining agreement described in section 414(f)(1)(B) and who has completed at least 10 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions, and

[(II) the requirements of subparagraph (A) or (B) are met with respect to employees not described in subclause (I).]

\* \* \* \* \*

#### SEC. 414. DEFINITIONS AND SPECIAL RULES.

(a) \* \* \*

(b) EMPLOYEES OF CONTROLLED GROUP OF CORPORATIONS.—For purposes of sections 401, 408(k), 408(p), 410, 411, 415, and 416, all employees of all corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(a)(4) and (e)(3)(C)) shall be treated as employed by a single employer. With respect to a plan adopted by more than one such corporation, the applicable limitations provided by section 404(a) shall be determined as if all such employers were a single employer, and allocated to each employer in accordance with regulations prescribed by the Secretary.

(c) EMPLOYEES OF PARTNERSHIPS, PROPRIETORSHIPS, ETC., WHICH ARE UNDER COMMON CONTROL.—For purposes of sections 401, 408(k), 408(p), 410, 411, 415, and 416, under regulations prescribed by the Secretary, all employees of trades or businesses (whether or not incorporated) which are under common control shall be treated as employed by a single employer. The regulations prescribed

under this subsection shall be based on principles similar to the principles which apply in the case of subsection (b).

\* \* \* \* \*

(m) EMPLOYEES OF AN AFFILIATED SERVICE GROUP.—

(1) \* \* \*

\* \* \* \* \*

(4) EMPLOYEE BENEFIT REQUIREMENTS.—For purposes of this subsection, the employee benefit requirements listed in this paragraph are—

(A) paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a), and

(B) sections 408(k), 408(p), 410, 411, 415, and 416.

\* \* \* \* \*

(n) EMPLOYEE LEASING.—

(1) \* \* \*

(2) LEASED EMPLOYEE.—For purposes of paragraph (1), the term “leased employee” means any person who is not an employee of the recipient and who provides services to the recipient if—

(A) \* \* \*

\* \* \* \* \*

[(C) such services are of a type historically performed, in the business field of the recipient, by employees.]

(C) such services are performed under primary direction or control by the recipient.

(3) REQUIREMENTS.—For purposes of this subsection, the requirements listed in this paragraph are—

(A) paragraphs (3), (4), (7), (16), (17), and (26) of section 401(a),

(B) sections 408(k), 408(p), 410, 411, 415, and 416, and

(C) sections 79, 106, 117(d), 120, 125, 127, 129, 132, 274(j), 505, and 4980B.

\* \* \* \* \*

(q) HIGHLY COMPENSATED EMPLOYEE.—

[(1) IN GENERAL.—The term “highly compensated employee” means any employee who, during the year or the preceding year—

[(A) was at any time a 5-percent owner,

[(B) received compensation from the employer in excess of \$75,000,

[(C) received compensation from the employer in excess of \$50,000 and was in the top-paid group of employees for such year, or

[(D) was at any time an officer and received compensation greater than 50 percent of the amount in effect under section 415(b)(1)(A) for such year.

The Secretary shall adjust the \$75,000 and \$50,000 amounts under this paragraph at the same time and in the same manner as under section 415(d).

[(2) SPECIAL RULE FOR CURRENT YEAR.—In the case of the year for which the relevant determination is being made, an

employee not described in subparagraph (B), (C), or (D) of paragraph (1) for the preceding year (without regard to this paragraph) shall not be treated as described in subparagraph (B), (C), or (D) of paragraph (1) unless such employee is a member of the group consisting of the 100 employees paid the greatest compensation during the year for which such determination is being made.】

(1) *IN GENERAL.*—The term “highly compensated employee” means any employee who—

(A) was a 5-percent owner at any time during the year or the preceding year, or

(B) for the preceding year—

(i) had compensation from the employer in excess of \$80,000, and

(ii) was in the top-paid group of the employer.

The Secretary shall adjust the \$80,000 amount under subparagraph (B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1996.

【(3)】 (2) 5-PERCENT OWNER.—An employee shall be treated as a 5-percent owner for any year if at any time during such year such employee was a 5-percent owner (as defined in section 416(i)(1)) of the employer.

【(4)】 (3) TOP-PAID GROUP.—An employee is in the top-paid group of employees for any year if such employee is in the group consisting of the top 20 percent of the employees when ranked on the basis of compensation paid during such year.

【(5)】 SPECIAL RULES FOR TREATMENT OF OFFICERS.—

【(A) NOT MORE THAN 50 OFFICERS TAKEN INTO ACCOUNT.—For purposes of paragraph (1)(D), no more than 50 employees (or, if lesser, the greater of 3 employees or 10 percent of the employees) shall be treated as officers.

【(B) AT LEAST 1 OFFICER TAKEN INTO ACCOUNT.—If for any year no officer of the employer is described in paragraph (1)(D), the highest paid officer of the employer for such year shall be treated as described in such paragraph.

【(6)】 TREATMENT OF CERTAIN FAMILY MEMBERS.—

【(A) IN GENERAL.—If any individual is a member of the family of a 5-percent owner or of a highly compensated employee in the group consisting of the 10 highly compensated employees paid the greatest compensation during the year, then—

【(i) such individual shall not be considered a separate employee, and

【(ii) any compensation paid to such individual (and any applicable contribution or benefit on behalf of such individual) shall be treated as if it were paid to (or on behalf of) the 5-percent owner or highly compensated employee.

【(B) FAMILY.—For purposes of subparagraph (A), the term “family” means, with respect to any employee, such employee’s spouse and lineal ascendants or descendants and the spouses of such lineal ascendants or descendants.

【(C) RULES TO APPLY TO OTHER PROVISIONS.—

[(i) IN GENERAL.—Except as provided in regulations and in clause (ii), the rules of subparagraph (A) shall be applied in determining the compensation of (or any contributions or benefits on behalf of) any employee for purposes of any section with respect to which a highly compensated employee is defined by reference to this subsection.

[(ii) EXCEPTION FOR DETERMINING INTEGRATION LEVELS.—Clause (i) shall not apply in determining the portion of the compensation of a participant which is under the integration level for purposes of section 401(l).

[(7) COMPENSATION.—For purposes of this subsection—

[(A) IN GENERAL.—The term “compensation” means compensation within the meaning of section 415(c)(3).

[(B) CERTAIN PROVISIONS NOT TAKEN INTO ACCOUNT.—The determination under subparagraph (A) shall be made—

[(i) without regard to sections 125, 402(e)(3), and 402(h)(1)(B), and

[(ii) in the case of employer contributions made pursuant to a salary reduction agreement, without regard to section 403(b).

[(8) EXCLUDED EMPLOYEES.—For purposes of subsection (r) and for purposes of determining the number of employees in the top-paid group under paragraph (4) or the number of officers taken into account under paragraph (5), the following employees shall be excluded—

[(A) employees who have not completed 6 months of service,

[(B) employees who normally work less than 17-1/2 hours per week,

[(C) employees who normally work during not more than 6 months during any year,

[(D) employees who have not attained age 21, and

[(E) except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer.

Except as provided by the Secretary, the employer may elect to apply subparagraph (A), (B), (C), or (D) by substituting a shorter period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age (as the case may be) than that specified in such subparagraph.

(4) *COMPENSATION.*—For purposes of this subsection, the term “compensation” has the meaning given such term by section 415(c)(3).

[(9)] (5) *FORMER EMPLOYEES.*—A former employee shall be treated as a highly compensated employee if—

(A) such employee was a highly compensated employee when such employee separated from service, or

(B) such employee was a highly compensated employee at any time after attaining age 55.

[(10)] (6) COORDINATION WITH OTHER PROVISIONS.—Subsections (b), (c), (m), (n), and (o) shall be applied before the application of this section.

[(11)] (7) SPECIAL RULE FOR NONRESIDENT ALIENS.—For purposes of this subsection and subsection (r), employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)) shall not be treated as employees.

[(12)] SIMPLIFIED METHOD FOR DETERMINING HIGHLY COMPENSATED EMPLOYEES.—

[(A)] IN GENERAL.—If an election by the employer under this paragraph applies to any year, in determining whether an employee is a highly compensated employee for such year—

[(i)] subparagraph (B) of paragraph (1) shall be applied by substituting “\$50,000” for “\$75,000”, and

[(ii)] subparagraph (C) of paragraph (1) shall not apply.

[(B)] REQUIREMENT FOR ELECTION.—An election under this paragraph shall not apply to any year unless—

[(i)] at all times during such year, the employer maintained significant business activities (and employed employees) in at least 2 significantly separate geographic areas, and

[(ii)] the employer satisfies such other conditions as the Secretary may prescribe.]

(r) SPECIAL RULES FOR SEPARATE LINE OF BUSINESS.—

(1) \* \* \*

(2) LINE OF BUSINESS MUST HAVE 50 EMPLOYEES, ETC.—A line of business shall not be treated as separate under paragraph (1) unless—

(A) such line of business has at least 50 employees who are not excluded under [subsection (q)(8)] paragraph (9),

\* \* \* \* \*

(9) EXCLUDED EMPLOYEES.—For purposes of this subsection, the following employees shall be excluded:

(A) Employees who have not completed 6 months of service.

(B) Employees who normally work less than 17½ hours per week.

(C) Employees who normally work not more than 6 months during any year.

(D) Employees who have not attained the age of 21.

(E) Except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer.

Except as provided by the Secretary, the employer may elect to apply subparagraph (A), (B), (C), or (D) by substituting a short-



*er period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age (as the case may be) specified in such subparagraph.*

(s) COMPENSATION.—For purposes of any applicable provision—

(1) \* \* \*

(2) EMPLOYER MAY ELECT NOT TO TREAT CERTAIN DEFERRALS AS COMPENSATION.—An employer may elect *not* to include as compensation any amount which is contributed by the employer pursuant to a salary reduction agreement and which is not includible in the gross income of an employee under section 125, 402(e)(3), 402(h), or 403(b).

\* \* \* \* \*

(u) SPECIAL RULES RELATING TO VETERANS' REEMPLOYMENT RIGHTS UNDER USERRA.—

(1) TREATMENT OF CERTAIN CONTRIBUTIONS MADE PURSUANT TO VETERANS' REEMPLOYMENT RIGHTS.—*If any contribution is made by an employer or an employee under an individual account plan with respect to an employee, or by an employee to a defined benefit plan that provides for employee contributions, and such contribution is required by reason of such employee's rights under chapter 43 of title 38, United States Code, resulting from qualified military service, then—*

(A) *such contribution shall not be subject to any otherwise applicable limitation contained in section 402(g), 402(h), 403(b), 404(a), 404(h), 408, 415, or 457, and shall not be taken into account in applying such limitations to other contributions or benefits under such plan or any other plan, with respect to the year in which the contribution is made,*

(B) *such contribution shall be subject to the limitations referred to in subparagraph (A) with respect to the year to which the contribution relates (in accordance with rules prescribed by the Secretary), and*

(C) *such plan shall not be treated as failing to meet the requirements of section 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 401(m), 403(b)(12), 408(k)(3), 408(k)(6), 408(p), 410(b), or 416 by reason of the making of (or the right to make) such contribution.*

*For purposes of the preceding sentence, any elective deferral or employee contribution made under paragraph (2) shall be treated as required by reason of the employee's rights under such chapter 43.*

(2) REEMPLOYMENT RIGHTS UNDER USERRA WITH RESPECT TO ELECTIVE DEFERRALS.—

(A) IN GENERAL.—*For purposes of this subchapter and section 457, if an employee is entitled to the benefits of chapter 43 of title 38, United States Code, with respect to any plan which provides for elective deferrals, the employer sponsoring the plan shall be treated as meeting the requirements of such chapter 43 with respect to such elective deferrals only if such employer—*

*(i) permits such employee to make additional elective deferrals under such plan (in the amount determined under subparagraph (B) or such lesser amount as is*

elected by the employee) during the period which begins on the date of the reemployment of such employee with such employer and has the same length as the lesser of—

- (I) the product of 3 and the period of qualified military service which resulted in such rights, and
- (II) 5 years, and

(ii) makes a matching contribution with respect to any additional elective deferral made pursuant to clause (i) which would have been required had such deferral actually been made during the period of such qualified military service.

(B) **AMOUNT OF MAKEUP REQUIRED.**—The amount determined under this subparagraph with respect to any plan is the maximum amount of the elective deferrals that the individual would have been permitted to make under the plan in accordance with the limitations referred to in paragraph (1)(A) during the period of qualified military service if the individual had continued to be employed by the employer during such period and received compensation as determined under paragraph (7). Proper adjustment shall be made to the amount determined under the preceding sentence for any elective deferrals actually made during the period of such qualified military service.

(C) **ELECTIVE DEFERRAL.**—For purposes of this paragraph, the term “elective deferral” has the meaning given such term by section 402(g)(3); except that such term shall include any deferral of compensation under an eligible deferred compensation plan (as defined in section 457(b)).

(D) **AFTER-TAX EMPLOYEE CONTRIBUTIONS.**—References in subparagraphs (A) and (B) to elective deferrals shall be treated as including references to employee contributions.

(3) **CERTAIN RETROACTIVE ADJUSTMENTS NOT REQUIRED.**—For purposes of this subchapter and subchapter E, no provision of chapter 43 of title 38, United States Code, shall be construed as requiring—

(A) any crediting of earnings to an employee with respect to any contribution before such contribution is actually made, or

(B) any allocation of any forfeiture with respect to the period of qualified military service.

(4) **LOAN REPAYMENT SUSPENSIONS PERMITTED.**—If any plan suspends the obligation to repay any loan made to an employee from such plan for any part of any period during which such employee is performing service in the uniformed services (as defined in chapter 43 of title 38, United States Code), whether or not qualified military service, such suspension shall not be taken into account for purposes of section 72(p), 401(a), or 4975(d)(1).

(5) **QUALIFIED MILITARY SERVICE.**—For purposes of this subsection, the term “qualified military service” means any service in the uniformed services (as defined in chapter 43 of title 38, United States Code) by any individual if such individual is en-

*titled to reemployment rights under such chapter with respect to such service.*

(6) *INDIVIDUAL ACCOUNT PLAN.*—For purposes of this subsection, the term “individual account plan” means any defined contribution plan (including any tax-sheltered annuity plan under section 403(b), any simplified employee pension under section 408(k), any qualified salary reduction arrangement under section 408(p), and any eligible deferred compensation plan (as defined in section 457(b))).

(7) *COMPENSATION.*—For purposes of sections 403(b)(3), 415(c)(3), and 457(e)(5), an employee who is in qualified military service shall be treated as receiving compensation from the employer during such period of qualified military service equal to—

(A) *the compensation the employee would have received during such period if the employee were not in qualified military service, determined based on the rate of pay the employee would have received from the employer but for absence during the period of qualified military service, or*

(B) *if the compensation the employee would have received during such period was not reasonably certain, the employee’s average compensation from the employer during the 12-month period immediately preceding the qualified military service (or, if shorter, the period of employment immediately preceding the qualified military service).*

(8) *USERRA REQUIREMENTS FOR QUALIFIED RETIREMENT PLANS.*—For purposes of this subchapter and section 457, an employer sponsoring a retirement plan shall be treated as meeting the requirements of chapter 43 of title 38, United States Code, only if each of the following requirements is met:

(A) *An individual reemployed under such chapter is treated with respect to such plan as not having incurred a break in service with the employer maintaining the plan by reason of such individual’s period of qualified military service.*

(B) *Each period of qualified military service served by an individual is, upon reemployment under such chapter, deemed with respect to such plan to constitute service with the employer maintaining the plan for the purpose of determining the nonforfeiture of the individual’s accrued benefits under such plan and for the purpose of determining the accrual of benefits under such plan.*

(C) *An individual reemployed under such chapter is entitled to accrued benefits that are contingent on the making of, or derived from, employee contributions or elective deferrals only to the extent the individual makes payment to the plan with respect to such contributions or deferrals. No such payment may exceed the amount the individual would have been permitted or required to contribute had the individual remained continuously employed by the employer throughout the period of qualified military service. Any payment to such plan shall be made during the period beginning with the date of reemployment and whose duration*

is 3 times the period of the qualified military service (but not greater than 5 years).

(9) *PLANS NOT SUBJECT TO TITLE 38.*—This subsection shall not apply to any retirement plan to which chapter 43 of title 38, United States Code, does not apply.

(10) *REFERENCES.*—For purposes of this section, any reference to chapter 43 of title 38, United States Code, shall be treated as a reference to such chapter as in effect on December 12, 1994 (without regard to any subsequent amendment).

**SEC. 415. LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS.**

(a) **GENERAL RULE.**—

(1) **TRUSTS.**—A trust which is a part of a pension, profitsharing, or stock bonus plan shall not constitute a qualified trust under section 401(a) if—

(A) in the case of a defined benefit plan, the plan provides for the payment of benefits with respect to a participant which exceed the limitation of subsection (b), or

(B) in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of subsection (c) **[, or].**

**[(C) in any case in which an individual is a participant in both a defined benefit plan and a defined contribution plan maintained by the employer, the trust has been disqualified under subsection (g).]**

\* \* \* \* \*

(b) **LIMITATION FOR DEFINED BENEFIT PLANS.**—

(1) \* \* \*

(2) **ANNUAL BENEFIT.**—

(A) \* \* \*

\* \* \* \* \*

(E) **LIMITATION ON CERTAIN ASSUMPTIONS.**—

(i) **【**Except as provided in clause (ii), for purposes of adjusting any benefit or limitation under subparagraph (B) or (C), **】** *For purposes of adjusting any limitation under subparagraph (C) and, except as provided in clause (ii), for purposes of adjusting any benefit under subparagraph (B),* the interest rate assumption shall not be less than the greater of 5 percent or the rate specified in the plan.

(ii) **【**For purposes of adjusting the benefit or limitation of any form of benefit subject to section 417(e)(3), **】** *For purposes of adjusting any benefit under subparagraph (B) for any form of benefit subject to section 417(e)(3),* the applicable interest rate (as defined in section 417(e)(3)) shall be substituted for “5 percent” in clause (i).

\* \* \* \* \*

(I) **EXEMPTION FOR SURVIVOR AND DISABILITY BENEFITS PROVIDED UNDER GOVERNMENTAL PLANS.**—*Subparagraph*

(C) of this paragraph and paragraph (5) shall not apply to—

(i) income received from a governmental plan (as defined in section 414(d)) as a pension, annuity, or similar allowance as the result of the recipient becoming disabled by reason of personal injuries or sickness, or

(ii) amounts received from a governmental plan by the beneficiaries, survivors, or the estate of an employee as the result of the death of the employee.

\* \* \* \* \*

(5) REDUCTION FOR PARTICIPATION OR SERVICE OF LESS THAN 10 YEARS.—

(A) \* \* \*

(B) COMPENSATION AND BENEFITS LIMITATIONS.—The provisions of subparagraph (A) shall apply to the limitations under paragraphs (1)(B) and (4) [and subsection (e)], except that such subparagraph shall be applied with respect to years of service with an employer rather than years of participation in a plan.

\* \* \* \* \*

(10) SPECIAL RULE FOR STATE AND LOCAL GOVERNMENT PLANS.—

(A) \* \* \*

\* \* \* \* \*

(C) ELECTION.—[This]

(i) *IN GENERAL.*—This paragraph shall not apply to any plan unless each employer maintaining the plan elects before the close of the 1st plan year beginning after December 31, 1989, to have this subsection (other than paragraph (2)(G)) applied without regard to paragraph (2)(F).

(ii) *REVOCATION OF ELECTION.*—An election under clause (i) may be revoked not later than the last day of the third plan year beginning after the date of the enactment of this clause. The revocation shall apply to all plan years to which the election applied and to all subsequent plan years. Any amount paid by a plan in a taxable year ending after the revocation shall be includible in income in such taxable year under the rules of this chapter in effect for such taxable year, except that, for purposes of applying the limitations imposed by this section, any portion of such amount which is attributable to any taxable year during which the election was in effect shall be treated as received in such taxable year.

(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL PLANS.—In the case of a governmental plan (as defined in section 414(d)), subparagraph (B) of paragraph (1) shall not apply.

(c) LIMITATION FOR DEFINED CONTRIBUTION PLANS.—

(1) \* \* \*

\* \* \* \* \*

(3) PARTICIPANT'S COMPENSATION.—For purposes of paragraph (1)—

(A) \* \* \*

\* \* \* \* \*

(C) SPECIAL RULES FOR PERMANENT AND TOTAL DISABILITY.—In the case of a participant in any defined contribution plan—

(i) who is permanently and totally disabled (as defined in section 22(e)(3)),

(ii) who is not a highly compensated employee (within the meaning of section 414(q)), and

(iii) with respect to whom the employer elects, at such time and in such manner as the Secretary may prescribe, to have this subparagraph apply,

the term “participant’s compensation” means the compensation the participant would have received for the year if the participant was paid at the rate of compensation paid immediately before becoming permanently and totally disabled. This subparagraph shall apply only if contributions made with respect to amounts treated as compensation under this subparagraph are nonforfeitable when made. *If a defined contribution plan provides for the continuation of contributions on behalf of all participants described in clause (i) for a fixed or determinable period, this subparagraph shall be applied without regard to clauses (ii) and (iii).*

(D) CERTAIN DEFERRALS INCLUDED.—The term “participant’s compensation” shall include—

(i) any elective deferral (as defined in section 402(g)(3)), and

(ii) any amount which is contributed by the employer at the election of the employee and which is not includible in the gross income of the employee under section 125 or 457.

\* \* \* \* \*

[(e) LIMITATION IN CASE OF DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN FOR SAME EMPLOYEE.—

[(1) IN GENERAL.—In any case in which an individual is a participant in both a defined benefit plan and a defined contribution plan maintained by the same employer, the sum of the defined benefit plan fraction and the defined contribution plan fraction for any year may not exceed 1.0.

[(2) DEFINED BENEFIT PLAN FRACTION.—For purposes of this subsection, the defined benefit plan fraction for any year is a fraction—

[(A) the numerator of which is the projected annual benefit of the participant under the plan (determined as of the close of the year), and

[(B) the denominator of which is the lesser of—

[(i) the product of 1.25, multiplied by the dollar limitation in effect under subsection (b)(1)(A) for such year, or

[(ii) the product of—

[(I) 1.4, multiplied by

[(II) the amount which may be taken into account under subsection (b)(1)(B) with respect to such individual under the plan for such year.

[(3) DEFINED CONTRIBUTION PLAN FRACTION.—For purposes of this subsection, the defined contribution plan fraction for any year is a fraction—

[(A) the numerator of which is the sum of the annual additions to the participant's account as of the close of the year, and

[(B) the denominator of which is the sum of the lesser of the following amounts determined for such year and for each prior year of service with the employer:

[(i) the product of 1.25, multiplied by the dollar limitation in effect under subsection (c)(1)(A) for such year (determined without regard to subsection (c)(6)), or

[(ii) the product of—

[(I) 1.4, multiplied by—

[(II) the amount which may be taken into account under subsection (c)(1)(B) (or subsection (c)(7), if applicable) with respect to such individual under such plan for such year.

[(4) SPECIAL TRANSITION RULES FOR DEFINED CONTRIBUTION FRACTION.—In applying paragraph (3) with respect to years beginning before January 1, 1976—

[(A) the aggregate amount taken into account under paragraph (3)(A) may not exceed the aggregate amount taken into account under paragraph (3)(B), and

[(B) the amount taken into account under subsection (c)(2)(B)(i) for any year concerned is an amount equal to—

[(i) the excess of the aggregate amount of employee contributions for all years beginning before January 1, 1976, during which the employee was an active participant of the plan, over 10 percent of the employee's aggregate compensation for all such years, multiplied by

[(ii) a fraction the numerator of which is 1 and the denominator of which is the number of years beginning before January 1, 1976, during which the employee was an active participant in the plan.

Employee contributions made on or after October 2, 1973, shall be taken into account under subparagraph (B) of the preceding sentence only to the extent that the amount of such contributions does not exceed the maximum amount of contributions permissible under the plan as in effect on October 2, 1973.

[(5) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—For purposes of this section, any annuity contract described in section 403(b) (except in the case of a participant who has elected under subsection (c)(4)(D) to have the provisions of subsection (c)(4)(C) apply) for the benefit of a participant shall be treated as a defined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). For purposes of this section, any contribution by

an employer to a simplified employee pension for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year. In the case of any annuity contract described in section 403(b), the amount of the contribution disqualified by reason of subsection (g) shall reduce the exclusion allowance as provided in section 403(b)(2).

**[(6) SPECIAL TRANSITION RULE FOR DEFINED CONTRIBUTION FRACTION FOR YEARS ENDING AFTER DECEMBER 31, 1982.—**

**[(A) IN GENERAL.—**At the election of the plan administrator, in applying paragraph (3) with respect to any year ending after December 31, 1982, the amount taken into account under paragraph (3)(B) with respect to each participant for all years ending before January 1, 1983, shall be an amount equal to the product of—

**[(i)** the amount determined under paragraph (3)(B) (as in effect for the year ending in 1982) for the year ending in 1982, multiplied by

**[(ii)** the transition fraction.

**[(B) TRANSITION FRACTION.—**The term “transition fraction” means a fraction—

**[(i)** the numerator of which is the lesser of—

**[(I)** \$51,875, or

**[(II)** 1.4, multiplied by 25 percent of the compensation of the participant for the year ending in 1981, and

**[(ii)** the denominator of which is the lesser of—

**[(I)** \$41,500, or

**[(II)** 25 percent of the compensation of the participant for the year ending in 1981.

**[(C) PLAN MUST HAVE BEEN IN EXISTENCE ON OR BEFORE JULY 1, 1982.—**This paragraph shall apply only to plans which were in existence on or before July 1, 1982.]

**(f) COMBINING OF PLANS.—**

**(1) IN GENERAL.—**For purposes of applying the limitations of **[(subsections (b), (c), and (e)) subsections (b) and (c)]**—

**(A)** all defined benefit plans (whether or not terminated) of an employer are to be treated as one defined benefit plan, and

**(B)** all defined contribution plans (whether or not terminated) of an employer are to be treated as one defined contribution plan.

\* \* \* \* \*

**(g) AGGREGATION OF PLANS.—**The Secretary, in applying the provisions of this section to benefits or contributions under more than one plan maintained by the same employer, and to any trusts, contracts, accounts, or bonds referred to in subsection (a)(2), with respect to which the participant has the control required under section 414(b) or (c), as modified by subsection (h), shall, under regulations prescribed by the Secretary, disqualify one or more trusts, plans, contracts, accounts, or bonds, or any combination thereof until such benefits or contributions do not exceed the limitations contained in this section. In addition to taking into account such other factors as may be necessary to carry out the purposes of



【subsections (e) and (f)】 *subsection (f)*, the regulations prescribed under this paragraph shall provide that no plan which has been terminated shall be disqualified until all other trusts, plans, contracts, accounts, or bonds have been disqualified.

\* \* \* \* \*

(k) SPECIAL RULES.—

(1) DEFINED BENEFIT PLAN AND DEFINED CONTRIBUTION PLAN.—For purposes of this title, the term “defined contribution plan” or “defined benefit plan” means a defined contribution plan (within the meaning of section 414(i)) or a defined benefit plan (within the meaning of section 414(j)), whichever applies, which is—

(A) a plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a),

(B) an annuity plan described in section 403(a),

(C) an annuity contract described in section 403(b), or

【(D) an individual retirement account described in section 408(a),

【(E) an individual retirement annuity described in section 408(b), or】

【(F)】 *(D)* a simplified employee pension.

(2) CONTRIBUTIONS TO PROVIDE COST-OF-LIVING PROTECTION UNDER DEFINED BENEFIT PLANS.—

(A) IN GENERAL.—In the case of a defined benefit plan which maintains a qualified cost-of-living arrangement—

【(i) any contribution made directly by an employee under such arrangement—

【(I) shall not be treated as an annual addition for purposes of subsection (c), but

【(II) shall be so treated for purposes of subsection (e), and】

*(i) any contribution made directly by an employee under such an arrangement shall not be treated as an annual addition for purposes of subsection (c), and*

*(ii) any benefit under such arrangement which is allocable to an employer contribution which was transferred from a defined contribution plan and to which the requirements of subsection (c) were applied shall, for purposes of subsection (b), be treated as a benefit derived from an employee contribution (and 【subsections (c) and (e)】 subsection (c) shall not again apply to such contribution by reason of such transfer).*

\* \* \* \* \*

(m) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—

(1) GOVERNMENTAL PLAN NOT AFFECTED.—*In determining whether a governmental plan (as defined in section 414(d)) meets the requirements of this section, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess ben-*

*efit arrangement shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.*

(2) **TAXATION OF PARTICIPANT.**—*For purposes of this chapter—*

*(A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and*

*(B) the treatment of such amounts when so includible by the participant, shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401.*

(3) **QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENT.**—*For purposes of this subsection, the term “qualified governmental excess benefit arrangement” means a portion of a governmental plan if—*

*(A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant’s annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by this section,*

*(B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation, and*

*(C) benefits described in subparagraph (A) are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.*

#### **SEC. 416. SPECIAL RULES FOR TOP-HEAVY PLANS.**

(a) \* \* \*

\* \* \* \* \*

(g) **TOP-HEAVY PLAN DEFINED.**—*For purposes of this section—*

(1) \* \* \*

\* \* \* \* \*

(4) **OTHER SPECIAL RULES.**—*For purposes of this subsection—*

(A) \* \* \*

\* \* \* \* \*

*(G) SIMPLE RETIREMENT ACCOUNTS.—The term “top-heavy plan” shall not include a simple retirement account under section 408(p).*

[(h) **ADJUSTMENTS IN SECTION 415 LIMITS FOR TOP-HEAVY PLANS.**—

**[(1) IN GENERAL.**—*In the case of any top-heavy plan, paragraphs (2)(B) and (3)(B) of section 415(e) shall be applied by substituting “1.0” for “1.25”.*

**[(2) EXCEPTION WHERE BENEFITS FOR KEY EMPLOYEES DO NOT EXCEED 90 PERCENT OF TOTAL BENEFITS AND ADDITIONAL CONTRIBUTIONS ARE MADE FOR NON-KEY EMPLOYEES.**—Paragraph

(1) shall not apply with respect to any top-heavy plan if the requirements of subparagraphs (A) and (B) of this paragraph are met with respect to such plan.

**[(A) MINIMUM BENEFIT REQUIREMENTS.—**

**[(i) IN GENERAL.—**The requirements of this subparagraph are met with respect to any top-heavy plan if such plan (and any plan required to be included in an aggregation group with such plan) meets the requirements of subsection (c) as modified by clause (ii).

**[(ii) MODIFICATIONS.—**For purposes of clause (i)—

**[(I) paragraph (1)(B) of subsection (c) shall be applied by substituting “3 percent” for “2 percent”, and by increasing (but not by more than 10 percentage points) 20 percent by 1 percentage point for each year for which such plan was taken into account under this subsection, and**

**[(II) paragraph (2)(A) shall be applied by substituting “4 percent” for “3 percent”.**

**[(B) BENEFITS FOR KEY EMPLOYEES CANNOT EXCEED 90 PERCENT OF TOTAL BENEFITS.—**A plan meets the requirements of this subparagraph if such plan would not be a top-heavy plan if “90 percent” were substituted for “60 percent” each place it appears in paragraphs (1)(A) and (2)(B) of subsection (g).

**[(3) TRANSITION RULE.—**If, but for this paragraph, paragraph (1) would begin to apply with respect to any top-heavy plan, the application of paragraph (1) shall be suspended with respect to any individual so long as there are no—

**[(A) employer contributions, forfeitures, or voluntary nondeductible contributions allocated to such individual, or**

**[(B) accruals for such individual under the defined benefit plan.**

**[(4) COORDINATION WITH TRANSITIONAL RULE UNDER SECTION 415.—**In the case of any top-heavy plan to which paragraph (1) applies, section 415(e)(6)(B)(i) shall be applied by substituting “\$41,500” for “\$51,875”.**]**

(i) **DEFINITIONS.—**For purposes of this section—

**(1) KEY EMPLOYEE.—**

**(A) IN GENERAL.—**The term “key employee” means an employee who, at any time during the plan year or any of the 4 preceding plan years, is—

**(i) \* \* \***

\* \* \* \* \*

For purposes of clause (i), no more than 50 employees (or, if lesser, the greater of 3 or 10 percent of the employees) shall be treated as officers. For purposes of clause (ii), if 2 employees have the same interest in the employer, the employee having greater annual compensation from the employer shall be treated as having a larger interest. Such term shall not include any officer or employee of an entity referred to in section 414(d) (relating to governmental plans). For purposes of determining the

number of officers taken into account under clause (i), employees described in section ~~414(q)(8)~~ 414(r)(9) shall be excluded.

\* \* \* \* \*

(D) COMPENSATION.—For purposes of this paragraph, the term “compensation” has the meaning given such term by section ~~414(q)(7)~~ 414(q)(4).

\* \* \* \* \*

#### **Subpart D—Treatment of Welfare Benefit Funds**

\* \* \* \* \*

#### **SEC. 419A. QUALIFIED ASSET ACCOUNT; LIMITATION ON ADDITIONS TO ACCOUNT.**

(a) \* \* \*

\* \* \* \* \*

(c) ACCOUNT LIMIT.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) AMOUNT TAKEN INTO ACCOUNT FOR SUB OR ~~SEVERANCE~~ SEVERANCE PAY BENEFITS.—

(A) IN GENERAL.—The account limit for any taxable year with respect to SUB or severance pay benefits is 75 percent of the average annual qualified direct costs for SUB or severance pay benefits for any 2 of the immediately preceding 7 taxable years (as selected by the fund).

\* \* \* \* \*

#### **Subpart E—Treatment of Transfers to Retiree Health Accounts**

\* \* \* \* \*

#### **SEC. 420. TRANSFERS OF EXCESS PENSION ASSETS TO RETIREE HEALTH ACCOUNTS.**

(a) \* \* \*

\* \* \* \* \*

(e) DEFINITION AND SPECIAL RULES.—For purposes of this section—

(1) QUALIFIED CURRENT RETIREE HEALTH LIABILITIES.—For purposes of this section—

(A) \* \* \*

\* \* \* \* \*

(C) APPLICABLE HEALTH BENEFITS.—The term “applicable health benefits” ~~mean~~ means health benefits or coverage which are provided to—

(i) \* \* \*

\* \* \* \* \*

#### **PART II—CERTAIN STOCK OPTIONS**

\* \* \* \* \*

**SEC. 424. DEFINITIONS AND SPECIAL RULES.**

(a) \* \* \*

\* \* \* \* \*

(c) DISPOSITION.—

(1) \* \* \*

\* \* \* \* \*

(3) SPECIAL RULE WHERE INCENTIVE STOCK IS ACQUIRED THROUGH USE OF OTHER STATUTORY OPTION STOCK.—

(A) \* \* \*

(B) STATUTORY OPTION STOCK.—For purpose of subparagraph (A), the term “statutory option stock” means any stock acquired through the exercise of [a qualified stock option, an incentive stock option, an option granted under an employee stock purchase plan, or a restricted stock option] *an incentive stock option or an option granted under an employee stock purchase plan.*

\* \* \* \* \*

## Subchapter E—Accounting Periods and Methods of Accounting

\* \* \* \* \*

### PART II—METHODS OF ACCOUNTING

\* \* \* \* \*

### Subpart B—Taxable Year for Which Items of Gross Income Included

\* \* \* \* \*

**SEC. 457. DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.**

(a) \* \* \*

(b) ELIGIBLE DEFERRED COMPENSATION PLAN DEFINED.—For purposes of this section, the term “eligible deferred compensation plan” means a plan established and maintained by an eligible employer—

(1) \* \* \*

\* \* \* \* \*

(6) *except as provided in subsection (g), which provides that—*

(A) \* \* \*

\* \* \* \* \*

(c) INDIVIDUALS WHO ARE PARTICIPANTS IN MORE THAN 1 PLAN.—

(1) \* \* \*

(2) COORDINATION WITH CERTAIN OTHER DEFERRALS.—In applying paragraph (1) of this subsection—

(A) \* \* \*

(B) any amount—

(i) excluded from gross income under section 402(e)(3) or section [402(h)(1)(B)] *402(h)(1)(B) or (k)* for the taxable year, or

\* \* \* \* \*

(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

[(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS.—If—

[(A) the total amount payable to a participant under the plan does not exceed \$3,500, and

[(B) no additional amounts may be deferred under the plan with respect to the participant, the amount payable to the participant under the plan shall not be treated as made available merely because such participant may elect to receive a lump sum payable after separation from service and within 60 days of the election.]]

(9) BENEFITS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—

(A) TOTAL AMOUNT PAYABLE IS \$3,500 OR LESS.—*The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if—*

*(i) such amount does not exceed \$3,500, and*

*(ii) such amount may be distributed only if—*

*(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and*

*(II) there has been no prior distribution under the plan to such participant to which this subparagraph applied.*

*A plan shall not be treated as failing to meet the distribution requirements of subsection (d) by reason of a distribution to which this subparagraph applies.*

(B) ELECTION TO DEFER COMMENCEMENT OF DISTRIBUTIONS.—*The total amount payable to a participant under the plan shall not be treated as made available merely because the participant may elect to defer commencement of distributions under the plan if—*

*(i) such election is made after amounts may be available under the plan in accordance with subsection (d)(1)(A) and before commencement of such distributions, and*

*(ii) the participant may make only 1 such election.*

\* \* \* \* \*

(14) TREATMENT OF QUALIFIED GOVERNMENTAL EXCESS BENEFIT ARRANGEMENTS.—*Subsections (b)(2) and (c)(1) shall not apply to any qualified governmental excess benefit arrangement (as defined in section 415(m)(3)), and benefits provided under such an arrangement shall not be taken into account in determining whether any other plan is an eligible deferred compensation plan.*

(15) COST-OF-LIVING ADJUSTMENT OF MAXIMUM DEFERRAL AMOUNT.—*The Secretary shall adjust the \$7,500 amount specified in subsections (b)(2) and (c)(1) at the same time and in the*

*same manner as under section 415(d), except that the base period shall be the calendar quarter ending September 30, 1994, and any increase under this paragraph which is not a multiple of \$500 shall be rounded to the next lowest multiple of \$500.*

(f) **TAX TREATMENT OF PARTICIPANTS WHERE PLAN OR ARRANGEMENT OF EMPLOYER IS NOT ELIGIBLE.**—

(1) \* \* \*

(2) **EXCEPTIONS.**—Paragraph (1) shall not apply to—

(A) \* \* \*

\* \* \* \* \*

(C) that portion of any plan which consists of a transfer of property described in section 83, **[and]**

(D) that portion of any plan which consists of a trust to which section 402(b) applies**[.]**, and

(E) a qualified governmental excess benefit arrangement described in section 415(m).

\* \* \* \* \*

(g) **GOVERNMENTAL PLANS MUST MAINTAIN SET-ASIDES FOR EXCLUSIVE BENEFIT OF PARTICIPANTS.**—

(1) **IN GENERAL.**—A plan maintained by an eligible employer described in subsection (e)(1)(A) shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries.

(2) **TAXABILITY OF TRUSTS AND PARTICIPANTS.**—For purposes of this title—

(A) a trust described in paragraph (1) shall be treated as an organization exempt from taxation under section 501(a), and

(B) notwithstanding any other provision of this title, amounts in the trust shall be includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in this section.

(3) **CUSTODIAL ACCOUNTS AND CONTRACTS.**—For purposes of this subsection, custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

\* \* \* \* \*

#### **SEC. 460. SPECIAL RULES FOR LONG-TERM CONTRACTS.**

(a) \* \* \*

\* \* \* \* \*

(b) **PERCENTAGE OF COMPLETION METHOD.**—

(1) \* \* \*

\* \* \* \* \*

In the case of any long-term contract with respect to which the percentage of completion method is used, except for purposes of applying **[the look-back method of paragraph (3)]** *the look-back method of paragraph (2)*, any income under the contract (to the extent not previously includible in gross income) shall be included in gross in-

come for the taxable year following the taxable year in which the contract was completed.

- \* \* \* \* \*
- (e) EXCEPTION FOR CERTAIN CONSTRUCTION CONTRACTS.—  
(1) \* \* \*

- \* \* \* \* \*
- (6) DEFINITIONS RELATING TO RESIDENTIAL CONSTRUCTION CONTRACTS.—For purposes of this subsection—  
(A) \* \* \*

(B) RESIDENTIAL CONSTRUCTION CONTRACT.—The term “residential construction contract” means any contract which would be described in subparagraph (A) if clause (i) of such subparagraph reads as follows:

“*(i) dwelling units (as defined in section [167(k)] 168(e)(2)(A)(ii)), and*”.

\* \* \* \* \*

### Subpart C—Taxable Year for Which Deductions Taken

\* \* \* \* \*

#### SEC. 461. GENERAL RULE FOR TAXABLE YEAR OF DEDUCTION.

- (a) \* \* \*
- \* \* \* \* \*
- (i) SPECIAL RULES FOR TAX SHELTERS.—  
(1) \* \* \*

\* \* \* \* \*

(3) TAX SHELTER DEFINED.—For purposes of this subsection, the term “tax shelter” means—

(A) \* \* \*

\* \* \* \* \*

(C) any tax shelter (as defined in [section 6662(d)(2)(C)(ii)] *section 6662(d)(2)(C)(iii)*).

\* \* \* \* \*

#### SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

- (a) \* \* \*
- \* \* \* \* \*
- (c) PASSIVE ACTIVITY DEFINED.—For purposes of this section—  
(1) \* \* \*

\* \* \* \* \*

(3) WORKING INTERESTS IN OIL AND GAS PROPERTY.—

(A) \* \* \*

(B) INCOME IN SUBSEQUENT YEARS.—If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activ-



*ity. If the preceding sentence applies to the net income from any property for any taxable year, any credits allowable under subpart B (other than section 27(a)) or D of part IV of subchapter A for such taxable year which are attributable to such property shall be treated as credits not from a passive activity to the extent the amount of such credits does not exceed the regular tax liability of the taxpayer for the taxable year which is allocable to such net income.*

\* \* \* \* \*

(g) DISPOSITIONS OF ENTIRE INTEREST IN PASSIVE ACTIVITY.—If during the taxable year a taxpayer disposes of his entire interest in any passive activity (or former passive activity), the following rules shall apply:

(1) FULLY TAXABLE TRANSACTION.—

[(A) IN GENERAL.—If all gain or loss realized on such disposition is recognized, the excess of—

[(i) the sum of—

[(I) any loss from such activity for such taxable year (determined after application of subsection (b)), plus

[(II) any loss realized on such disposition, over

[(ii) net income or gain for such taxable year from all passive activities (determined without regard to losses described in clause (i)), shall be treated as a loss which is not from a passive activity.]

(A) IN GENERAL.—*If all gain or loss realized on such disposition is recognized, the excess of—*

*(i) any loss from such activity for such taxable year (determined after the application of subsection (b)), over*

*(ii) any net income or gain for such taxable year from all other passive activities (determined after the application of subsection (b)),*

*shall be treated as a loss which is not from a passive activity.*

\* \* \* \* \*

## Subchapter F—Exempt Organizations

\* \* \* \* \*

### PART I—GENERAL RULE

\* \* \* \* \*

#### SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.

(a) \* \* \*

\* \* \* \* \*

(c) LIST OF EXEMPT ORGANIZATIONS.—The following organizations are referred to in subsection (a):

(1) \* \* \*

\* \* \* \* \*

(21)(A) \* \* \*

\* \* \* \* \*

(D) For purposes of this paragraph:

(i) \* \* \*

(ii) The term “qualified investments” means—

(I) \* \* \*

\* \* \* \* \*

(III) time or demand deposits in a bank (as defined in section 581) or an insured credit union (within the meaning of section ~~101(6)~~ 101(7) of the Federal Credit Union Act, 12 U.S.C. ~~1752(6)~~ 1752(7)) located in the United States.

\* \* \* \* \*

(n) CHARITABLE RISK POOLS.—

(1) IN GENERAL.—For purposes of this title—

(A) a qualified charitable risk pool shall be treated as an organization organized and operated exclusively for charitable purposes, and

(B) subsection (m) shall not apply to a qualified charitable risk pool.

(2) QUALIFIED CHARITABLE RISK POOL.—For purposes of this subsection, the term “qualified charitable risk pool” means any organization—

(A) which is organized and operated solely to pool insurable risks of its members (other than risks related to medical malpractice) and to provide information to its members with respect to loss control and risk management,

(B) which is comprised solely of members that are organizations described in subsection (c)(3) and exempt from tax under subsection (a), and

(C) which meets the organizational requirements of paragraph (3).

(3) ORGANIZATIONAL REQUIREMENTS.—An organization (hereinafter in this subsection referred to as the “risk pool”) meets the organizational requirements of this paragraph if—

(A) such risk pool is organized as a nonprofit organization under State law provisions authorizing risk pooling arrangements for charitable organizations,

(B) such risk pool is exempt from any income tax imposed by the State (or will be so exempt after such pool qualifies as an organization exempt from tax under this title),

(C) such risk pool has obtained at least \$1,000,000 in startup capital from nonmember charitable organizations,

(D) such risk pool is controlled by a board of directors elected by its members, and

(E) the organizational documents of such risk pool require that—

(i) each member of such pool shall at all times be an organization described in subsection (c)(3) and exempt from tax under subsection (a),

(ii) any member which receives a final determination that it no longer qualifies as an organization described

in subsection (c)(3) shall immediately notify the pool of such determination and the effective date of such determination, and

(iii) each policy of insurance issued by the risk pool shall provide that such policy will not cover the insured with respect to events occurring after the date such final determination was issued to the insured.

An organization shall not cease to qualify as a qualified charitable risk pool solely by reason of the failure of any of its members to continue to be an organization described in subsection (c)(3) if, within a reasonable period of time after such pool is notified as required under subparagraph (C)(ii), such pool takes such action as may be reasonably necessary to remove such member from such pool.

(4) **OTHER DEFINITIONS.**—For purposes of this subsection—

(A) **STARTUP CAPITAL.**—The term “startup capital” means any capital contributed to, and any program-related investments (within the meaning of section 4944(c)) made in, the risk pool before such pool commences operations.

(B) **NONMEMBER CHARITABLE ORGANIZATION.**—The term “nonmember charitable organization” means any organization which is described in subsection (c)(3) and exempt from tax under subsection (a) and which is not a member of the risk pool and does not benefit (directly or indirectly) from the insurance coverage provided by the pool to its members.

[(n)] (o) **CROSS REFERENCE.**—

**For nonexemption of Communist-controlled organizations, see section 11(b) of the Internal Security Act of 1950 (64 Stat. 997; 50 U.S.C. 790(b)).**

\* \* \* \* \*

### **PART III—TAXATION OF BUSINESS INCOME OF CERTAIN EXEMPT ORGANIZATIONS**

\* \* \* \* \*

#### **SEC. 512. UNRELATED BUSINESS TAXABLE INCOME.**

(a) \* \* \*

(b) **MODIFICATIONS.**—The modifications referred to in subsection (a) are the following:

(1) \* \* \*

\* \* \* \* \*

(17) **TREATMENT OF CERTAIN AMOUNTS DERIVED FROM FOREIGN CORPORATIONS.**—

(A) **IN GENERAL.**—Notwithstanding paragraph (1), any amount included in gross income under section 951(a)(1)(A) shall be included as an item of gross income derived from an unrelated trade or business to the extent the amount so included is attributable to insurance income (as defined in section 953) which, if derived directly by the organization, would be treated as gross income from an unrelated trade or business. There shall be allowed all deductions directly connected with amounts included in gross income under the preceding sentence.

(B) *EXCEPTION.*—Subparagraph (A) shall not apply to income attributable to a policy of insurance or reinsurance with respect to which the person (directly or indirectly) insured is—

- (i) such organization,
- (ii) an affiliate of such organization which is exempt from tax under section 501(a), or
- (iii) a director or officer of, or an individual who (directly or indirectly) performs services for, such organization or affiliate but only if the insurance covers primarily risks associated with the performance of services in connection with such organization or affiliate.

For purposes of this subparagraph, the determination as to whether an entity is an affiliate of an organization shall be made under rules similar to the rules of section 168(h)(4)(B).

(C) *REGULATIONS.*—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations for the application of this paragraph in the case of income paid through 1 or more entities or between 2 or more chains of entities.

\* \* \* \* \*

(d) *TREATMENT OF DUES OF AGRICULTURAL OR HORTICULTURAL ORGANIZATIONS.*—

(1) *IN GENERAL.*—If—

(A) an agricultural or horticultural organization described in section 501(c)(5) requires annual dues to be paid in order to be a member of such organization, and

(B) the amount of such required annual dues does not exceed \$100,

in no event shall any portion of such dues be treated as derived by such organization from an unrelated trade or business by reason of any benefits or privileges to which members of such organization are entitled.

(2) *INDEXATION OF \$100 AMOUNT.*—In the case of any taxable year beginning in a calendar year after 1995, the \$100 amount in paragraph (1) shall be increased by an amount equal to—

(A) \$100, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting “calendar year 1994” for “calendar year 1992” in subparagraph (B) thereof.

(3) *DUES.*—For purposes of this subsection, the term “dues” includes any payment required to be made in order to be recognized by the organization as a member of the organization.

## Subchapter G—Corporations Used to Avoid Income tax on Shareholders

\* \* \* \* \*

## PART I—CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS

\* \* \* \* \*

### SEC. 537. REASONABLE NEEDS OF THE BUSINESS.

(a) \* \* \*

(b) SPECIAL RULES.—For purposes of subsection (a)—

(1) \* \* \*

\* \* \* \* \*

(4) PRODUCT LIABILITY LOSS RESERVES.—The accumulation of reasonable amounts for the payment of reasonably anticipated product liability losses (as defined in section ~~172(i)~~ 172(f)), as determined under regulations prescribed by the Secretary, shall be treated as accumulated for the reasonably anticipated needs of the business.

\* \* \* \* \*

## PART II—PERSONAL HOLDING COMPANIES

\* \* \* \* \*

### SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) GENERAL RULE.—For purposes of this subtitle, the term “personal holding company income” means the portion of the adjusted ordinary gross income which consists of:

(1) \* \* \*

(2) RENTS.—The adjusted income from rents; except that such adjusted income shall not be included if—

(A) such adjusted income constitutes 50 percent or more of the adjusted ordinary gross income, and

(B) the sum of—

(i) the dividends paid during the taxable year (determined under section 562),

(ii) the dividends considered as paid on the last day of the taxable year under section ~~563(c)~~ 563(d) (as limited by the second sentence of section 563(b)), and

\* \* \* \* \*

## Subchapter I—Natural Resources

\* \* \* \* \*

## PART I—DEDUCTIONS

\* \* \* \* \*

### SEC. 613. PERCENTAGE DEPLETION.

(a) \* \* \*

\* \* \* \* \*

(e) PERCENTAGE DEPLETION FOR GEOTHERMAL DEPOSITS.—

(1) IN GENERAL.—In the case of geothermal deposits located in the United States or in a possession of the United States, for purposes of subsection (a)—

- (A) such deposits shall be treated as listed in subsection (b), and  
 (B) 15 percent shall be deemed to be the percentage specified in paragraph (b) **[.1]**,

\* \* \* \* \*

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

(a) \* \* \*

\* \* \* \* \*

(c) **EXEMPTION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS.**—

(1) \* \* \*

\* \* \* \* \*

(3) **DEPLETABLE OIL QUANTITY.**—

(A) **IN GENERAL.**—For purposes of paragraph (1), the taxpayer's depletable oil quantity shall be equal to—

(i) the tentative quantity determined under **[the table contained in]** subparagraph (B), reduced (but not below zero) by

(ii) except in the case of a taxpayer making an election under paragraph (6)(B), the taxpayer's average daily marginal production for the taxable year.

\* \* \* \* \*

**Subchapter J—Estates, Trusts, Beneficiaries, and Decedents**

\* \* \* \* \*

**PART I—ESTATES, TRUSTS, AND BENEFICIARIES**

\* \* \* \* \*

**Subpart A—General Rules for Taxation of Estates and Trusts**

\* \* \* \* \*

**SEC. 641. IMPOSITION OF TAX.**

(a) \* \* \*

\* \* \* \* \*

(d) **SPECIAL RULES FOR TAXATION OF ELECTING SMALL BUSINESS TRUSTS.**—

(1) **IN GENERAL.**—For purposes of this chapter—

(A) the portion of any electing small business trust which consists of stock in 1 or more S corporations shall be treated as a separate trust, and

(B) the amount of the tax imposed by this chapter on such separate trust shall be determined with the modifications of paragraph (2).

(2) **MODIFICATIONS.**—For purposes of paragraph (1), the modifications of this paragraph are the following:

(A) *Except as provided in section 1(h), the amount of the tax imposed by section 1(e) shall be determined by using the highest rate of tax set forth in section 1(e).*

(B) *The exemption amount under section 55(d) shall be zero.*

(C) *The only items of income, loss, deduction, or credit to be taken into account are the following:*

(i) *The items required to be taken into account under section 1366.*

(ii) *Any gain or loss from the disposition of stock in an S corporation.*

(iii) *To the extent provided in regulations, State or local income taxes or administrative expenses to the extent allocable to items described in clauses (i) and (ii). No deduction or credit shall be allowed for any amount not described in this paragraph, and no item described in this paragraph shall be apportioned to any beneficiary.*

(D) *No amount shall be allowed under paragraph (1) or (2) of section 1211(b).*

(3) *TREATMENT OF REMAINDER OF TRUST AND DISTRIBUTIONS.—For purposes of determining—*

(A) *the amount of the tax imposed by this chapter on the portion of any electing small business trust not treated as a separate trust under paragraph (1), and*

(B) *the distributable net income of the entire trust, the items referred to in paragraph (2)(C) shall be excluded. Except as provided in the preceding sentence, this subsection shall not affect the taxation of any distribution from the trust.*

(4) *TREATMENT OF UNUSED DEDUCTIONS WHERE TERMINATION OF SEPARATE TRUST.—If a portion of an electing small business trust ceases to be treated as a separate trust under paragraph (1), any carryover or excess deduction of the separate trust which is referred to in section 642(h) shall be taken into account by the entire trust.*

(5) *ELECTING SMALL BUSINESS TRUST.—For purposes of this subsection, the term “electing small business trust” has the meaning given such term by section 1361(e)(1).*

#### **SEC. 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.**

(a) \* \* \*

\* \* \* \* \*

(g) **DISALLOWANCE OF DOUBLE DEDUCTIONS.**—Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction (or as an offset against the sales price of property in determining gain or loss) in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. Rules similar to the rules of the preceding sentence shall apply to amounts which may be taken into account under section 2621(a)(2) or

2622(b). This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents).

\* \* \* \* \*

## **PART II—INCOME IN RESPECT OF DECEDENTS**

\* \* \* \* \*

### **SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.**

(a) \* \* \*

\* \* \* \* \*

(c) DEDUCTION FOR ESTATE TAX.—

(1) \* \* \*

\* \* \* \* \*

[(5) COORDINATION WITH SECTION 402(d).—For purposes of section 402(d) (other than paragraph (1)(C) thereof), the total taxable amount of any lump sum distribution shall be reduced by the amount of the deduction allowable under paragraph (1) of this subsection which is attributable to the total taxable amount (determined without regard to this paragraph).]

\* \* \* \* \*

## **Subchapter K—Partners and Partnerships**

\* \* \* \* \*

## **PART II—CONTRIBUTIONS, DISTRIBUTIONS, AND TRANSFERS**

\* \* \* \* \*

### **Subpart A—Contributions to a Partnership**

\* \* \* \* \*

### **SEC. 724. CHARACTER OF GAIN OR LOSS ON CONTRIBUTED UNREALIZED RECEIVABLES, INVENTORY ITEMS, AND CAPITAL LOSS PROPERTY.**

(a) \* \* \*

\* \* \* \* \*

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

(1) \* \* \*

\* \* \* \* \*

(3) SUBSTITUTED BASIS PROPERTY.—

(A) IN GENERAL.—If any property described in subsection (a), (b), or (c) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of non-recognition transactions.

(B) EXCEPTION FOR STOCK IN C CORPORATION.—  
[Subparagraph] *Subparagraph* (A) shall not apply to any



stock in a C corporation received in an exchange described in section 351.

\* \* \* \* \*

## Subchapter L—Insurance Companies

\* \* \* \* \*

### PART I—LIFE INSURANCE COMPANIES

\* \* \* \* \*

#### Subpart C—Life Insurance Deductions

\* \* \* \* \*

#### SEC. 805. GENERAL DEDUCTIONS.

(a) GENERAL RULE.—For purposes of this part, there shall be allowed the following deductions:

(1) \* \* \*

\* \* \* \* \*

(4) DIVIDENDS RECEIVED BY COMPANY.—

(A) \* \* \*

\* \* \* \* \*

(E) CERTAIN DIVIDENDS RECEIVED BY FOREIGN CORPORATIONS.—Subparagraph (A)(i) (and not subparagraph (A)(ii)) shall apply to any dividend received by a foreign corporation from a domestic corporation which would be a 100 percent dividend if section 1504(b)(3) did not apply for purposes of applying section [243(b)(5)] 243(b)(2).

\* \* \* \* \*

#### SEC. 807. RULES FOR CERTAIN RESERVES.

(a) \* \* \*

\* \* \* \* \*

(d) METHOD OF COMPUTING RESERVES FOR PURPOSES OF DETERMINING INCOME.—

(1) \* \* \*

\* \* \* \* \*

(3) TAX RESERVE METHOD.—For purposes of this subsection—

(A) \* \* \*

(B) DEFINITION OF CRVM AND CARVM.—For purposes of this paragraph—

(i) CRVM.—The term “CRVM” means the Commissioners’ Reserve Valuation Method prescribed by the National Association of Insurance Commissioners which is in effect on the date of the issuance of the contract.

(ii) CARVM.—The term “CARVM” means the [Commissioners’] *Commissioners’* Annuities Reserve Valuation Method prescribed by the National Associa-

tion of Insurance Commissioners which is in effect on the date of the issuance of the contract.

\* \* \* \* \*

#### **Subpart D—Accounting, Allocation, and Foreign Provisions**

\* \* \* \* \*

#### **SEC. 812. DEFINITION OF COMPANY'S SHARE AND POLICYHOLDERS' SHARE.**

(a) \* \* \*

\* \* \* \* \*

[(g) TREATMENT OF INTEREST PARTIALLY TAX-EXEMPT UNDER SECTION 133.—For purposes of this section and subsections (a) and (b) of section 807, the terms “gross investment income” and “tax-exempt interest” shall not include any interest received with respect to a securities acquisition loan (as defined in section 133(b)). Such interest shall not be included in life insurance gross income for purposes of subsection (b)(3).]

\* \* \* \* \*

### **PART II—OTHER INSURANCE COMPANIES**

\* \* \* \* \*

#### **SEC. 832. INSURANCE COMPANY TAXABLE INCOME.**

(a) \* \* \*

(b) DEFINITIONS.—In the case of an insurance company subject to the tax imposed by section 831—

(1) \* \* \*

\* \* \* \* \*

(5) LOSSES INCURRED.—

(A) \* \* \*

\* \* \* \* \*

(C) EXCEPTION FOR INVESTMENTS MADE BEFORE AUGUST 8, 1986.—

(i) IN GENERAL.—Except as provided in clause (ii), subparagraph (B) shall not apply to any dividend or interest received or accrued on any stock or obligation acquired before August 8, 1986.

(ii) SPECIAL RULE FOR 100 PERCENT DIVIDENDS.—For purposes of clause (i), the portion of any 100 percent dividend which is attributable to prorated amounts shall be treated as received with respect to stock acquired on the later of—

(I) the date the payor acquired the stock or obligation to which the prorated amounts are attributable, or

(II) the 1st day on which the payor and payee were members of the same affiliated group (as defined in section [243(b)(5)] 243(b)(2)).

(D) DEFINITIONS.—For purposes of this paragraph—

(i) PRORATED AMOUNTS.—The term “prorated amounts” means tax-exempt interest and dividends

with respect to which a deduction is allowable under section 243, 244, or 245 (other than 100 percent dividends).

(ii) 100 PERCENT DIVIDEND.—

(I) IN GENERAL.—The term “100 percent dividend” means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100 percent.

(II) CERTAIN DIVIDENDS RECEIVED BY FOREIGN CORPORATIONS.—A dividend received by a foreign corporation from a domestic corporation which would be a 100 percent dividend if section 1504(b)(3) did not apply for purposes of applying section ~~243(b)(5)~~ 243(b)(2) shall be treated as a 100 percent dividend.

\* \* \* \* \*

## Subchapter M—Regulated Investment Companies and Real Estate Investment Trusts

\* \* \* \* \*

### PART I—REGULATED INVESTMENT COMPANIES

\* \* \* \* \*

#### SEC. 852. TAXATION OF REGULATED INVESTMENT COMPANIES AND THEIR SHAREHOLDERS.

(a) \* \* \*

\* \* \* \* \*

(b) METHOD OF TAXATION OF COMPANIES AND SHAREHOLDERS.—  
(1) \* \* \*

\* \* \* \* \*

(5) EXEMPT-INTEREST DIVIDENDS.—If, at the close of each quarter of its taxable year, at least 50 percent of the value (as defined in section 851(c)(4)) of the total assets of the regulated investment company consists of obligations described in section 103(a), such company shall be qualified to pay exempt-interest dividends, as defined herein, to its shareholders.

(A) \* \* \*

\* \* \* \* \*

[(C) INTEREST ON CERTAIN LOANS USED TO ACQUIRE EMPLOYER SECURITIES.—For purposes of this section—

[(i) 50 percent of the amount of any loan of the regulated investment company which qualifies as a securities acquisition loan (as defined in section 133) shall be treated as an obligation described in section 103(a), and

[(ii) 50 percent of the interest received on such loan shall be treated as interest excludable from gross income under section 103.]

\* \* \* \* \*

## PART II—REAL ESTATE INVESTMENT TRUSTS

\* \* \* \* \*

### SEC. 856. DEFINITION OF REAL ESTATE INVESTMENT TRUST.

(a) IN GENERAL.—For purposes of this title, the term “real estate investment trust” means a corporation, trust, or association—

(1) \* \* \*

\* \* \* \* \*

(4) which is neither (A) a financial institution referred to in section [582(c)(5)] 582(c)(2), nor (B) an insurance company to which subchapter L applies;

\* \* \* \* \*

## PART IV—REAL ESTATE MORTGAGE INVESTMENT CONDUITS

\* \* \* \* \*

### SEC. 860E. TREATMENT OF INCOME IN EXCESS OF DAILY ACCRUALS ON RESIDUAL INTERESTS.

(a) EXCESS INCLUSIONS MAY NOT BE OFFSET BY NET OPERATING LOSSES.—

(1) \* \* \*

\* \* \* \* \*

(6) COORDINATION WITH MINIMUM TAX.—For purposes of part VI of subchapter A of this chapter—

(A) the reference in section 55(b)(2) to taxable income shall be treated as a reference to taxable income determined without regard to this subsection,

(B) the alternative minimum taxable income of any holder of a residual interest in a REMIC for any taxable year shall in no event be less than the excess inclusion for such taxable year, and

(C) any excess inclusion shall be disregarded for purposes of computing the alternative tax net operating loss deduction.

The preceding sentence shall not apply to any organization to which section 593 applies, except to the extent provided in regulations prescribed by the Secretary under paragraph (2).

\* \* \* \* \*

### SEC. 860F. OTHER RULES.

(a) 100 PERCENT TAX ON PROHIBITED TRANSACTIONS.—

(1) \* \* \*

\* \* \* \* \*

(5) EXCEPTIONS.—Notwithstanding subparagraphs (A) and (D) of paragraph [(1)] (2), the term “prohibited transaction” shall not include any disposition—

(A) required to prevent default on a regular interest where the threatened default resulted from a default on 1 or more qualified mortgages, or

(B) to facilitate a clean-up call (as defined in regulations).

\* \* \* \* \*

## **Subchapter N—Tax Bases on Income from Sources Within or Without the United States**

\* \* \* \* \*

### **PART I—DETERMINATION OF SOURCES OF INCOME**

\* \* \* \* \*

#### **SEC. 865. SOURCE RULES FOR PERSONAL PROPERTY SALES.**

(a) \* \* \*

(b) **EXCEPTION FOR INVENTORY PROPERTY.**—In the case of income derived from the sale of inventory property—

(1) this section shall not apply, and

(2) such income shall be sourced under the rules of sections 861(a)(6), 862(a)(6), and 863(b).

Notwithstanding the preceding sentence, any income from the sale of any unprocessed timber which is a softwood and was cut from an area in the United States shall be sourced in the United States and the rules of sections 862(a)(6) and 863[(b)] shall not apply to any such income. For purposes of the preceding sentence, the term “unprocessed timber” means any log, cant, or similar form of timber.

\* \* \* \* \*

### **PART II—NONRESIDENT ALIENS AND FOREIGN CORPORATIONS**

\* \* \* \* \*

#### **Subpart A—Nonresident Alien Individuals**

\* \* \* \* \*

#### **SEC. 871. TAX ON NONRESIDENT ALIEN INDIVIDUALS.**

(a) \* \* \*

(b) **INCOME CONNECTED WITH UNITED STATES BUSINESS—GRADUATED RATE OF TAX.**—

(1) **IMPOSITION OF TAX.**—A nonresident alien individual engaged in trade or business within the United States during the taxable year shall be taxable as provided in [section 1, 55, or 402(d)(1)] *section 1 or 55* on his taxable income which is effectively connected with the conduct of a trade or business within the United States.

\* \* \* \* \*

#### **SEC. 877. EXPATRIATION TO AVOID TAX.**

(a) \* \* \*

(b) **ALTERNATIVE TAX.**—A nonresident alien individual described in subsection (a) shall be taxable for the taxable year as provided in [section 1, 55, or 402(d)(1)] *section 1 or 55*, except that—

(1) \* \* \*

\* \* \* \* \*

### Subpart B—Foreign Corporations

\* \* \* \* \*

#### SEC. 884. BRANCH PROFITS TAX.

(a) \* \* \*

\* \* \* \* \*

(f) **TREATMENT OF INTEREST ALLOCABLE TO EFFECTIVELY CONNECTED INCOME.**—

(1) **IN GENERAL.**—In the case of a foreign corporation engaged in a trade or business in the United States (or having gross income treated as effectively connected with the conduct of a trade or business in the United States), for purposes of this subtitle—

(A) any interest paid by such trade or business in the United States shall be treated as if it were paid by a domestic corporation, and

(B) [to the extent the amount of interest allowable as a deduction under section 882 in computing the effectively connected taxable income of such foreign corporation exceeds the interest described in subparagraph (A)] *to the extent that the allocable interest exceeds the interest described in subparagraph (A)*, such foreign corporation shall be liable for tax under section 881(a) in the same manner as if such excess were interest paid to such foreign corporation by a wholly owned domestic corporation on the last day of such foreign corporation's taxable year.

To the extent provided in regulations, subparagraph (A) shall not apply to interest in excess of the amounts [reasonably expected to be deductible under section 882 in computing the effectively connected taxable income of such foreign corporation.] *reasonably expected to be allocable interest.*

[(2) **EFFECTIVELY CONNECTED TAXABLE INCOME.**—For purposes of this subsection, the term “effectively connected taxable income” means taxable income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.]

(2) **ALLOCABLE INTEREST.**—*For purposes of this subsection, the term “allocable interest” means any interest which is allocable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States.*

\* \* \* \* \*

### Subpart D—Miscellaneous Provisions

\* \* \* \* \*

**SEC. 897. DISPOSITION OF INVESTMENT IN UNITED STATES REAL PROPERTY.**

(a) \* \* \*

\* \* \* \* \*

[(f) DISTRIBUTIONS BY DOMESTIC CORPORATIONS TO FOREIGN SHAREHOLDERS.—If a domestic corporation distributes a United States real property interest to a nonresident alien individual or a foreign corporation in a distribution to which section 301 applies, notwithstanding any other provision of this chapter, the basis of such United States real property interest in the hands of such nonresident alien individual or foreign corporation shall not exceed—

[(1) the adjusted basis of such property before the distribution, increased by

[(2) the sum of—

[(A) any gain recognized by the distributing corporation on the distribution, and

[(B) any tax paid under this chapter by the distributee on such distribution.]]

\* \* \* \* \*

**PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES**

\* \* \* \* \*

**Subpart A—Foreign Tax Credit**

\* \* \* \* \*

**SEC. 904. LIMITATION ON CREDIT.**

(a) \* \* \*

\* \* \* \* \*

(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.—

(1) \* \* \*

\* \* \* \* \*

(3) LOOK-THRU IN CASE OF CONTROLLED FOREIGN CORPORATIONS.—

(A) \* \* \*

\* \* \* \* \*

(G) DIVIDEND.—For purposes of this paragraph, the term “dividend” includes any amount included in gross income in [section 951(a)(1)(B)] *subparagraph (B) or (C) of section 951(a)(1)*. Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

\* \* \* \* \*

(f) RECAPTURE OF OVERALL FOREIGN LOSS.—

(1) \* \* \*

(2) OVERALL FOREIGN LOSS DEFINED.—For purposes of this subsection, the term “overall foreign loss” means the amount

by which the gross income for the taxable year from sources without the United States (whether or not the taxpayer chooses the benefits of this subpart for such taxable year) for such year is exceeded by the sum of the deductions properly apportioned or allocated thereto, except that there shall not be taken into account—

(A) any net operating loss deduction allowable for such year under section 172(a), and

(B) any—

(i) foreign expropriation loss for such year, as defined in section 172(h) (*as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990*), or

(ii) loss for such year which arises from fire, storm, shipwreck, or other casualty, or from theft, to the extent such loss is not compensated for by insurance or otherwise.

\* \* \* \* \*

#### **SEC. 907. SPECIAL RULES IN CASE OF FOREIGN OIL AND GAS INCOME. \* \* \***

\* \* \* \* \*

(c) **FOREIGN INCOME DEFINITIONS AND SPECIAL RULES.**—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(4) **RECAPTURE OF FOREIGN OIL AND GAS EXTRACTION LOSSES BY RECHARACTERIZING LATER EXTRACTION INCOME.**—

(A) \* \* \*

(B) **FOREIGN OIL EXTRACTION LOSS DEFINED.**—

(i) \* \* \*

\* \* \* \* \*

(iii) **EXPROPRIATION AND CASUALTY LOSSES NOT TAKEN INTO ACCOUNT.**—For purposes of clause (i), there shall not be taken into account—

(I) any foreign expropriation loss (as defined in section 172(h) (*as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990*)) for the taxable year, or

(II) any loss for the taxable year which arises from fire, storm, shipwreck, or other casualty, or from theft,

to the extent such loss is not compensated for by insurance or otherwise.

#### **Subpart D—Possessions of the United States**

\* \* \* \* \*

#### **SEC. 936. PUERTO RICO AND POSSESSION TAX CREDIT.**

(a) \* \* \*

(b) **AMOUNTS RECEIVED IN UNITED STATES.**—In determining taxable income for purposes of subsection (a), there shall not be taken into account as income from sources without the United States any



gross income which was received by such domestic corporation within the United States, whether derived from sources within or without the United States. This subsection shall not apply to any amount described in subsection (a)(1)(A)(i) received from a person who is not a related person (within the meaning of subsection (h)(3) but without regard to subparagraphs (D)(ii) and (E)(i) thereof with respect to the domestic corporation.

\* \* \* \* \*

(j) **TERMINATION.**—

(1) **IN GENERAL.**—*Except as otherwise provided in this subsection, this section shall not apply to any taxable year beginning after December 31, 1995.*

(2) **TRANSITION RULES FOR ACTIVE BUSINESS INCOME CREDIT.**—*Except as provided in paragraph (3)—*

(A) **ECONOMIC ACTIVITY CREDIT.**—*In the case of an existing credit claimant—*

(i) *with respect to a possession other than Puerto Rico, and*

(ii) *to which subsection (a)(4)(B) does not apply, the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 2002.*

(B) **SPECIAL RULE FOR REDUCED CREDIT.**—

(i) **IN GENERAL.**—*In the case of an existing credit claimant to which subsection (a)(4)(B) applies, the credit determined under subsection (a)(1)(A) shall be allowed for taxable years beginning after December 31, 1995, and before January 1, 1998.*

(ii) **ELECTION IRREVOCABLE AFTER 1997.**—*An election under subsection (a)(4)(B)(iii) which is in effect for the taxpayer's last taxable year beginning before 1997 may not be revoked unless it is revoked for the taxpayer's first taxable year beginning in 1997 and all subsequent taxable years.*

(C) **ECONOMIC ACTIVITY CREDIT FOR PUERTO RICO.**—

**For economic activity credit for Puerto Rico, see section 30A.**

(3) **ADDITIONAL RESTRICTED CREDIT.**—

(A) **IN GENERAL.**—*In the case of an existing credit claimant—*

(i) *the credit under subsection (a)(1)(A) shall be allowed for the period beginning with the first taxable year after the last taxable year to which subparagraph (A) or (B) of paragraph (2), whichever is appropriate, applied and ending with the last taxable year beginning before January 1, 2006, except that*

(ii) *the aggregate amount of taxable income taken into account under subsection (a)(1)(A) for any such taxable year shall not exceed the adjusted base period income of such claimant.*

(B) **COORDINATION WITH SUBSECTION (a)(4).**—*The amount of income described in subsection (a)(1)(A) which is taken into account in applying subsection (a)(4) shall be such income as reduced under this paragraph.*

(4) *ADJUSTED BASE PERIOD INCOME.*—For purposes of paragraph (3)—

(A) *IN GENERAL.*—The term “adjusted base period income” means the average of the inflation-adjusted possession incomes of the corporation for each base period year.

(B) *INFLATION-ADJUSTED POSSESSION INCOME.*—For purposes of subparagraph (A), the inflation-adjusted possession income of any corporation for any base period year shall be an amount equal to the sum of—

(i) the possession income of such corporation for such base period year, plus

(ii) such possession income multiplied by the inflation adjustment percentage for such base period year.

(C) *INFLATION ADJUSTMENT PERCENTAGE.*—For purposes of subparagraph (B), the inflation adjustment percentage for any base period year means the percentage (if any) by which—

(i) the CPI for 1995, exceeds

(ii) the CPI for the calendar year in which the base period year for which the determination is being made ends.

For purposes of the preceding sentence, the CPI for any calendar year is the CPI (as defined in section 1(f)(5)) for such year under section 1(f)(4).

(D) *INCREASE IN INFLATION ADJUSTMENT PERCENTAGE FOR GROWTH DURING BASE YEARS.*—The inflation adjustment percentage (determined under subparagraph (C) without regard to this subparagraph) for each of the 5 taxable years referred to in paragraph (5)(A) shall be increased by—

(i) 5 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1995;

(ii) 10.25 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1994;

(iii) 15.76 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1993;

(iv) 21.55 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1992; and

(v) 27.63 percentage points in the case of a taxable year ending during the 1-year period ending on October 13, 1991.

(5) *BASE PERIOD YEAR.*—For purposes of this subsection—

(A) *IN GENERAL.*—The term “base period year” means each of 3 taxable years which are among the 5 most recent taxable years of the corporation ending before October 14, 1995, determined by disregarding—

(i) one taxable year for which the corporation had the largest inflation-adjusted possession income, and

(ii) one taxable year for which the corporation had the smallest inflation-adjusted possession income.

**(B) CORPORATIONS NOT HAVING SIGNIFICANT POSSESSION INCOME THROUGHOUT 5-YEAR PERIOD.—**

(i) **IN GENERAL.**—If a corporation does not have significant possession income for each of the most recent 5 taxable years ending before October 14, 1995, then, in lieu of applying subparagraph (A), the term “base period year” means only those taxable years (of such 5 taxable years) for which the corporation has significant possession income; except that, if such corporation has significant possession income for 4 of such 5 taxable years, the rule of subparagraph (A)(ii) shall apply.

(ii) **SPECIAL RULE.**—If there is no year (of such 5 taxable years) for which a corporation has significant possession income—

(I) the term “base period year” means the first taxable year ending on or after October 14, 1995, but

(II) the amount of possession income for such year which is taken into account under paragraph (4) shall be the amount which would be determined if such year were a short taxable year ending on September 30, 1995.

(iii) **SIGNIFICANT POSSESSION INCOME.**—For purposes of this subparagraph, the term “significant possession income” means possession income which exceeds 2 percent of the possession income of the taxpayer for the taxable year (of the period of 6 taxable years ending with the first taxable year ending on or after October 14, 1995) having the greatest possession income.

**(C) ELECTION TO USE ONE BASE PERIOD YEAR.—**

(i) **IN GENERAL.**—At the election of the taxpayer, the term “base period year” means—

(I) only the last taxable year of the corporation ending in calendar year 1992, or

(II) a deemed taxable year which includes the first ten months of calendar year 1995.

(ii) **BASE PERIOD INCOME FOR 1995.**—In determining the adjusted base period income of the corporation for the deemed taxable year under clause (i)(II), the possession income shall be annualized and shall be determined without regard to any extraordinary item.

(iii) **ELECTION.**—An election under this subparagraph by any possession corporation may be made only for the corporation’s first taxable year beginning after December 31, 1995, for which it is a possession corporation. The rules of subclauses (II) and (III) of subsection (a)(4)(B)(iii) shall apply to the election under this subparagraph.

**(D) ACQUISITIONS AND DISPOSITIONS.**—Rules similar to the rules of subparagraphs (A) and (B) of section 41(f)(3) shall apply for purposes of this subsection.

**(6) POSSESSION INCOME.**—For purposes of this subsection, the term “possession income” means, with respect to any possession, the income referred to in subsection (a)(1)(A) determined with

respect to that possession. In no event shall possession income be treated as being less than zero.

(7) *SHORT YEARS.*—If the current year or a base period year is a short taxable year, the application of this subsection shall be made with such annualizations as the Secretary shall prescribe.

(8) *SPECIAL RULES FOR CERTAIN POSSESSIONS.*—

(A) *IN GENERAL.*—In the case of an existing credit claimant with respect to an applicable possession, this section (other than the preceding paragraphs of this subsection) shall apply to such claimant with respect to such applicable possession for taxable years beginning after December 31, 1995, and before January 1, 2006.

(B) *APPLICABLE POSSESSION.*—For purposes of this paragraph, the term “applicable possession” means Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

(9) *EXISTING CREDIT CLAIMANT.*—For purposes of this subsection—

(A) *IN GENERAL.*—The term “existing credit claimant” means a corporation—

(i) which was actively conducting a trade or business in a possession on October 13, 1995, and

(ii) with respect to which an election under this section is in effect for the corporation’s taxable year which includes October 13, 1995.

(B) *NEW LINES OF BUSINESS PROHIBITED.*—If, after October 13, 1995, a corporation which would (but for this subparagraph) be an existing credit claimant adds a substantial new line of business, such corporation shall cease to be treated as an existing credit claimant as of the close of the taxable year ending before the date of such addition.

(C) *BINDING CONTRACT EXCEPTION.*—If, on October 13, 1995, and at all times thereafter, there is in effect with respect to a corporation a binding contract for the acquisition of assets to be used in, or for the sale of assets to be produced from, a trade or business, the corporation shall be treated for purposes of this paragraph as actively conducting such trade or business on October 13, 1995. The preceding sentence shall not apply if such trade or business is not actively conducted before January 1, 1996.

(10) *SEPARATE APPLICATION TO EACH POSSESSION.*—In the case of any taxpayer, this subsection (and so much of this section as relates to this subsection) shall be applied separately with respect to each possession.

\* \* \* \* \*

## Subpart F—Controlled Foreign Corporations

Sec. 951. Amounts included in gross income of United States shareholders.

\* \* \* \* \*

[Sec. 956A. Earnings invested in excess passive assets.]

\* \* \* \* \*

**SEC. 951. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.**

**(a) AMOUNTS INCLUDED.—**

(1) **IN GENERAL.**—If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year,

(ii) his pro rata share (determined under section 955(a)(3) as in effect before the enactment of the Tax Reduction Act of 1975) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year, and

(iii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from foreign base company shipping operations for such year, *and*

(B) the amount determined under section 956 with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)); **and**

**[(C) the amount determined under section 956A with respect to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(3)).]**

\* \* \* \* \*

**[SEC. 956A. EARNINGS INVESTED IN EXCESS PASSIVE ASSETS.**

**[(a) GENERAL RULE.**—In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of—

**[(1) the excess (if any) of—**

**[(A) such shareholder's pro rata share of the amount of the controlled foreign corporation's excess passive assets for such taxable year, over**

**[(B) the amount of earnings and profits described in section 959(c)(1)(B) with respect to such shareholder, or**

**[(2) such shareholder's pro rata share of the applicable earnings of such controlled foreign corporation determined after the application of section 951(a)(1)(B).**

**[(b) Applicable Earnings.**—For purposes of this section, the term “applicable earnings” means, with respect to any controlled foreign corporation, the sum of—

[(1) the amount (not including a deficit) referred to in section 316(a)(1) to the extent such amount was accumulated in prior taxable years beginning after September 30, 1993, and

[(2) the amount referred to in section 316(a)(2), but reduced by distributions made during the taxable year and reduced by the earnings and profits described in section 959(c)(1) to the extent that the earnings and profits so described were accumulated in taxable years beginning after September 30, 1993.

[(c) EXCESS PASSIVE ASSETS.—For purposes of this section—

[(1) IN GENERAL.—The excess passive assets of any controlled foreign corporation for any taxable year is the excess (if any) of—

[(A) the average of the amounts of passive assets held by such corporation as of the close of each quarter of such taxable year, over

[(B) 25 percent of the average of the amounts of total assets held by such corporation as of the close of each quarter of such taxable year.

For purposes of the preceding sentence, the amount taken into account with respect to any asset shall be its adjusted basis as determined for purposes of computing earnings and profits.

[(2) PASSIVE ASSET.—

[(A) IN GENERAL.—Except as otherwise provided in this section, the term “passive asset” means any asset held by the controlled foreign corporation which produces passive income (as defined in section 1296(b)) or is held for the production of such income.

[(B) COORDINATION WITH SECTION 956.—The term “passive asset” shall not include any United States property (as defined in section 956).

[(3) CERTAIN RULES TO APPLY.—For purposes of this subsection, the rules of the following provisions shall apply:

[(A) Section 1296(c) (relating to look-thru rules).

[(B) Section 1297(d) (relating to leasing rules).

[(C) Section 1297(e) (relating to intangible property).

[(d) TREATMENT OF CERTAIN GROUPS OF CONTROLLED FOREIGN CORPORATIONS.—

[(1) IN GENERAL.—For purposes of applying subsection (c)—

[(A) all controlled foreign corporations which are members of the same CFC group shall be treated as 1 controlled foreign corporation, and

[(B) the amount of the excess passive assets determined with respect to such 1 corporation shall be allocated among the controlled foreign corporations which are members of such group in proportion to their respective amounts of applicable earnings.

[(2) CFC GROUP.—For purposes of paragraph (1), the term “CFC group” means 1 or more chains of controlled foreign corporations connected through stock ownership with a top tier corporation which is a controlled foreign corporation, but only if—

[(A) the top tier corporation owns directly more than 50 percent (by vote or value) of the stock of at least 1 of the other controlled foreign corporations, and

[(B) more than 50 percent (by vote or value) of the stock of each of the controlled foreign corporations (other than the top tier corporation) is owned (directly or indirectly) by one or more other members of the group.

[(e) SPECIAL RULE WHERE CORPORATION CEASES TO BE CONTROLLED FOREIGN CORPORATION DURING TAXABLE YEAR.—If any foreign corporation ceases to be a controlled foreign corporation during any taxable year—

[(1) the determination of any United States shareholder's pro rata share shall be made on the basis of stock owned (within the meaning of section 958(a)) by such shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation, and

[(2) the amount of such corporation's excess passive assets for such taxable year shall be determined by only taking into account quarters ending on or before such last day, and

[(3) in determining applicable earnings, the amount taken into account by reason of being described in paragraph (2) of section 316(a) shall be the portion of the amount so described which is allocable (on a pro rata basis) to the part of such year during which the corporation is a controlled foreign corporation.

[(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section, including regulations to prevent the avoidance of the provisions of this section through reorganizations or otherwise and regulations coordinating the provisions of subsections (c)(3)(A) and (d).]

#### **SEC. 958. RULES FOR DETERMINING STOCK OWNERSHIP.**

(a) DIRECT AND INDIRECT OWNERSHIP.—

(1) GENERAL RULE.—For purposes of this subpart (other than [sections 955(b)(1)(A) and (B), 955(c)(2)(A)(ii), and 960(a)(1)] section 960(a)(1)), stock owned means—

(A) stock owned directly, and

(B) stock owned with the application of paragraph (2).

\* \* \* \* \*

(b) CONSTRUCTIVE OWNERSHIP.—For purposes of sections 951(b), 954(d)(3), [956(b)(2)] 956(c)(2), and 957, section 318(a) (relating to constructive ownership of stock) shall apply to the extent that the effect is to treat any United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), to treat the stock of a domestic corporation as owned by a United States shareholder of the controlled foreign corporation for purposes of section [956(b)(2)] 956(c)(2), or to treat a foreign corporation as a controlled foreign corporation under section 957, except that—

(1) In applying paragraph (1)(A) of section 318(a), stock owned by a nonresident alien individual (other than a foreign trust or foreign estate) shall not be considered as owned by a citizen or by a resident alien individual.

(2) In applying subparagraphs (A), (B), and (C) of section 318(a)(2), if a partnership, estate, trust, or corporation owns, directly or indirectly, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of a

corporation, it shall be considered as owning all the stock entitled to vote.

(3) In applying subparagraph (C) of section 318(a)(2), the phrase “10 percent” shall be substituted for the phrase “50 percent” used in subparagraph (C).

(4) Subparagraph (A), (B), and (C) of section 318(a)(3) shall not be applied so as to consider a United States person as owning stock which is owned by a person who is not a United States person.

Paragraphs (1) and (4) shall not apply for purposes of section **956(b)(2)** ~~956(c)(2)~~ to treat stock of a domestic corporation as not owned by a United States shareholder.

\* \* \* \* \*

#### **SEC. 959. EXCLUSION FROM GROSS INCOME OF PREVIOUSLY TAXED EARNINGS AND PROFITS.**

(a) **EXCLUSION FROM GROSS INCOME OF UNITED STATES PERSONS.**—For purposes of this chapter, the earnings and profits of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when—

(1) such amounts are distributed to, *or*

(2) such amounts would, but for this subsection, be included under section 951(a)(1)(B) in the gross income of, **or**

**[(3) such amounts would, but for this subsection, be included under section 951(a)(1)(C) in the gross income of,]**

such shareholder (or any other United States person who acquires from any person any portion of the interest of such United States shareholder in such foreign corporation, but only to the extent of such portion, and subject to such proof of the identity of such interest as the Secretary may by regulations prescribe) directly or indirectly through a chain of ownership described under section 958(a), be again included in the gross income of such United States shareholder (or of such other United States person). The rules of subsection (c) shall apply for purposes of paragraph (1) of this subsection and the rules of subsection (f) shall apply for purposes of **[paragraphs (2) and (3)]** *paragraph (2)* of this subsection.

\* \* \* \* \*

(c) **ALLOCATION OF DISTRIBUTIONS.**—For purposes of subsections (a) and (b), section 316(a) shall be applied by applying paragraph (2) thereof, and then paragraph (1) thereof—

(1) \* \* \*

\* \* \* \* \*

(3) then to other earnings and profits.

*References in this subsection to section 951(a)(1)(C) and subsection (a)(3) shall be treated as references to such provisions as in effect on the day before the date of the enactment of the Small Business Job Protection Act of 1996.*

\* \* \* \* \*

(f) **ALLOCATION RULES FOR CERTAIN INCLUSIONS.**—

**[(1) IN GENERAL.**—For purposes of this section—

**[(A) amounts that would be included under subparagraph (B) of section 951(a)(1) (determined without regard**



to this section) shall be treated as attributable first to earnings described in subsection (c)(2), and then to earnings described in subsection (c)(3), and

[(B) amounts that would be included under subparagraph (C) of section 951(a)(1) (determined without regard to this section) shall be treated as attributable first to earnings described in subsection (c)(2) to the extent the earnings so described were accumulated in taxable years beginning after September 30, 1993, and then to earnings described in subsection (c)(3).]

(1) *IN GENERAL.*—For purposes of this section, amounts that would be included under subparagraph (B) of section 951(a)(1) (determined without regard to this section) shall be treated as attributable first to earnings described in subsection (c)(2), and then to earnings described in subsection (c)(3).

(2) *TREATMENT OF DISTRIBUTIONS.*—In applying this section, actual distributions shall be taken into account before amounts that would be included under [subparagraphs (B) and (C) of section 951(a)(1)] *section 951(a)(1)(B)* (determined without regard to this section).

\* \* \* \* \*

## Subpart J—Foreign Currency Transactions

\* \* \* \* \*

### SEC. 989. OTHER DEFINITIONS AND SPECIAL RULES.

(a) \* \* \*

(b) *APPROPRIATE EXCHANGE RATE.*—Except as provided in regulations, for purposes of this subpart, the term “appropriate exchange rate” means—

(1) \* \* \*

\* \* \* \* \*

(4) in the case of any other qualified business unit of a taxpayer, the weighted average exchange rate for the taxable year of such qualified business unit.

For purposes of the preceding sentence, any amount included in income under [subparagraph (B) or (C) of section 951(a)(1)] *section 951(a)(1)(B)* shall be treated as an actual distribution made on the last day of the taxable year for which such amount was so included.

\* \* \* \* \*

## Subchapter O—Gain or Loss on Disposition of Property

\* \* \* \* \*

### PART II—BASIS RULES OF GENERAL APPLICATION

\* \* \* \* \*

### SEC. 1017. DISCHARGE OF INDEBTEDNESS.

(a) \* \* \*

(b) AMOUNT AND PROPERTIES DETERMINED UNDER REGULATIONS.—

(1) \* \* \*

\* \* \* \* \*

(4) SPECIAL RULES FOR QUALIFIED FARM INDEBTEDNESS.—

(A) IN GENERAL.—Any amount which under subsection [(b)(2)(D)] (b)(2)(E) of section 108 is to be applied to reduce basis and which is attributable to an amount excluded under subsection (a)(1)(C) of section 108—

(i) \* \* \*

\* \* \* \* \*

**PART III—COMMON NONTAXABLE EXCHANGE**

\* \* \* \* \*

**SEC. 1042. SALES OF STOCK TO EMPLOYEE STOCK OWNERSHIP PLANS OR CERTAIN COOPERATIVES.**

(a) \* \* \*

\* \* \* \* \*

(c) DEFINITIONS; SPECIAL RULES.—

For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(4) QUALIFIED REPLACEMENT PROPERTY.—

(A) IN GENERAL.—The term “qualified replacement property” means any security issued by a domestic operating corporation which—

(i) did not, for the taxable year preceding the taxable year in which such security was purchased, have passive investment income (as defined in section [1362(d)(3)(D)] 1362(d)(3)(C)) in excess of 25 percent of the gross receipts of such corporation for such preceding taxable year, and

\* \* \* \* \*

**SEC. 1044. ROLLOVER OF PUBLICLY TRADED SECURITIES GAIN INTO SPECIALIZED SMALL BUSINESS INVESTMENT COMPANIES.**

(a) \* \* \*

\* \* \* \* \*

(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) \* \* \*

[(2) PURCHASE.—The term “purchase” has the meaning given such term by section 1043(b)(4).]

(2) PURCHASE.—*The taxpayer shall be considered to have purchased any property if, but for subsection (d), the unadjusted basis of such property would be its cost within the meaning of section 1012.*

\* \* \* \* \*

## Subchapter P—Capital Gains and Losses

### PART I—TREATMENT OF CAPITAL GAINS

\* \* \* \* \*

#### SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain and any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever is applicable) exceeds 35 percent (determined without regard to the ~~last sentence~~ *last 2 sentences* of section 11(b)(1)), then, in lieu of any such tax, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

(2) a tax of 34 percent of the net capital gain.

\* \* \* \* \*

### PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

\* \* \* \* \*

#### SEC. 1237. REAL PROPERTY SUBDIVIDED FOR SALE.

(a) GENERAL.—Any lot or parcel which is part of a tract of real property in the hands of a taxpayer ~~other than a corporation~~ *other than a C corporation* shall not be deemed to be held primarily for sale to customers in the ordinary course of trade or business at the time of sale solely because of the taxpayer having subdivided such tract for purposes of sale or because of any activity incident to such subdivision or sale, if—

(1) such tract, or any lot or parcel thereof, had not previously been held by such taxpayer primarily for sale to customers in the ordinary course of trade or business (unless such tract at such previous time would have been covered by this section) and, in the same taxable year in which the sale occurs, such taxpayer does not so hold any other real property; and

(2) no substantial improvement that substantially enhances the value of the lot or parcel sold is made by the taxpayer on such tract while held by the taxpayer or is made pursuant to a contract of sale entered into between the taxpayer and the buyer. For purposes of this paragraph, an improvement shall be deemed to be made by the taxpayer if such improvement was made by—

(A) the taxpayer or members of his family (as defined in section 267(c)(4)), by a corporation controlled by the taxpayer, *an S corporation which included the taxpayer as a shareholder*, or by a partnership which included the taxpayer as a partner; or

\* \* \* \* \*

#### SEC. 1245. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY.

(a) GENERAL RULE.—

(1) \* \* \*

\* \* \* \* \*

[(3) SECTION 1245 PROPERTY.—For purposes of this section, the term “section 1245 property” means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 (or subject to the allowance of amortization provided in ) and is either—]

(3) SECTION 1245 PROPERTY.—For purposes of this section, the term “section 1245 property” means any property which is or has been property of a character subject to the allowance for depreciation provided in section 167 and is either—

(A) \* \* \*

\* \* \* \* \*

#### SEC. 1248. GAIN FROM CERTAIN SALES OR EXCHANGES OF STOCK IN CERTAIN FOREIGN CORPORATIONS.

(a) GENERAL RULE.—If—

(1) a United States person sells or exchanges stock in a foreign corporation[, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock], and

\* \* \* \* \*

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation. *For purposes of this section, a United States person shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such person is treated as realizing gain from the sale or exchange of such stock.*

\* \* \* \* \*

(e) SALES OR EXCHANGES OF STOCK IN CERTAIN DOMESTIC CORPORATIONS.—Except as provided in regulations prescribed by the Secretary, if—

(1) a United States person sells or exchanges stock of a domestic corporation[, or receives a distribution from a domestic corporation which, under section 302 or 331, is treated as an exchange of stock], and

\* \* \* \* \*

(f) CERTAIN NONRECOGNITION TRANSACTIONS.—Except as provided in regulations prescribed by the Secretary—

(1) IN GENERAL.—If—

(A) a domestic corporation satisfies the stock ownership requirements of subsection (a)(2) with respect to a foreign corporation, and

(B) such domestic corporation distributes stock of such foreign corporation in a distribution to which section 311(a), 337, [or 361(c)(1)] 355(c)(1), or 361(c)(1) applies,

then, notwithstanding any other provision of this subtitle, an amount equal to the excess of the fair market value of such stock over its adjusted basis in the hands of the domestic corporation shall be included in the gross income of the domestic corporation as a dividend to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by such domestic corporation while such foreign corporation was a controlled foreign corporation. For purposes of subsections (c)(2), (d), and (h), a distribution of stock to which this subsection applies shall be treated as a sale of stock to which subsection (a) applies.

\* \* \* \* \*

(i) TREATMENT OF CERTAIN INDIRECT TRANSFERS.—

[(1) IN GENERAL.—If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, for purposes of this section, the stock of the foreign corporation received in such exchange shall be treated as if it had been—

[(A) issued to the 10-percent corporate shareholder, and

[(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).]

*(1) IN GENERAL.—If any shareholder of a 10-percent corporate shareholder of a foreign corporation exchanges stock of the 10-percent corporate shareholder for stock of the foreign corporation, such 10-percent corporate shareholder shall recognize gain in the same manner as if the stock of the foreign corporation received in such exchange had been—*

*(A) issued to the 10-percent corporate shareholder, and*

*(B) then distributed by the 10-percent corporate shareholder to such shareholder in redemption or liquidation (whichever is appropriate).*

*The amount of gain recognized by such 10-percent corporate shareholder under the preceding sentence shall not exceed the amount treated as a dividend under this section.*

\* \* \* \* \*

**SEC. 1250. GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE REALTY.**

(a) \* \* \*

\* \* \* \* \*

(e) HOLDING PERIOD.—For purposes of determining the applicable percentage under this section, the provisions of section 1223 shall not apply, and the holding period of section 1250 property shall be determined under the following rules:

(1) \* \* \*

\* \* \* \* \*

[(4) QUALIFIED LOW-INCOME HOUSING.—The holding period of any section 1250 property acquired which is described in sub-

section (d)(8)(E)(i) shall include the holding period of the corresponding element of section 1250 property disposed of.】

\* \* \* \* \*

## PART V—SPECIAL RULES FOR BONDS AND OTHER DEBT INSTRUMENTS

\* \* \* \* \*

### Subpart A—Original Issue Discount

\* \* \* \* \*

#### SEC. 1274. DETERMINATION OF ISSUE PRICE IN THE CASE OF CERTAIN DEBT INSTRUMENTS ISSUED FOR PROPERTY.

(a) \* \* \*

(b) IMPUTED PRINCIPAL AMOUNT.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) FAIR MARKET VALUE RULE IN POTENTIALLY ABUSIVE SITUATIONS.—

(A) \* \* \*

(B) POTENTIALLY ABUSIVE SITUATION DEFINED.— For purposes of subparagraph (A), the term “potentially abusive situation” means—

(i) a tax shelter (as defined in section 【6662(d)(2)(C)(ii)】 6662(d)(2)(C)(iii)), and

\* \* \* \* \*

#### SEC. 1274A. SPECIAL RULES FOR CERTAIN TRANSACTIONS WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED \$2,800,000.

(a) \* \* \*

\* \* \* \* \*

(c) ELECTION TO USE CASH METHOD WHERE STATED PRINCIPAL AMOUNT DOES NOT EXCEED \$2,000,000.—

(1) IN GENERAL.—In the case of any cash method debt instrument—

(A) section 1274 shall not apply, and

(B) interest on such debt 【instrument】 *instrument* shall be taken into account by both the borrower and the lender under the cash receipts and disbursements method of accounting.

\* \* \* \* \*

## PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

\* \* \* \* \*

### Subpart C—General Provisions

\* \* \* \* \*

#### SEC. 1296. PASSIVE FOREIGN INVESTMENT COMPANY.

(a) \* \* \*

(b) **PASSIVE INCOME.**—For purposes of this section—

(1) \* \* \*

(2) **EXCEPTIONS.**—Except as provided in regulations, the term “passive income” does not include any income—

(A) derived in the active conduct of a banking business by an institution licensed to do business as a bank in the United States (or, to the extent provided in regulations, by any other corporation),

(B) derived in the active conduct of an insurance business by a corporation which is predominantly engaged in an insurance business and which would be subject to tax under subchapter L if it were a domestic corporation, **[or]**

(C) which is interest, a dividend, or a rent or royalty, which is received or accrued from a related person (within the meaning of section 954(d)(3)) to the extent such amount is properly allocable (under regulations prescribed by the Secretary) to income of such related person which is not passive income~~[\.]~~, or

(D) *which is foreign trade income of a FSC or export trade income of an export trade corporation (as defined in section 971).*

For purposes of subparagraph (C), the term “related person” has the meaning given such term by section 954(d)(3) determined by substituting “foreign corporation” for “controlled foreign corporation” each place it appears in section 954(d)(3).

\* \* \* \* \*

#### **SEC. 1297. SPECIAL RULES.**

(a) \* \* \*

\* \* \* \* \*

(d) **TREATMENT OF CERTAIN LEASED PROPERTY.**—For purposes of this part—

(1) \* \* \*

**[(2) DETERMINATION OF ADJUSTED BASIS.—]**

(2) **AMOUNT TAKEN INTO ACCOUNT.**—

(A) **IN GENERAL.**—**[The adjusted basis of any asset]** *The amount taken into account under section 1296(a)(2) with respect to any asset to which paragraph (1) applies shall be the unamortized portion (as determined under regulations prescribed by the Secretary) of the present value of the payments under the lease for the use of such property.*

\* \* \* \* \*

(e) **SPECIAL RULES FOR CERTAIN INTANGIBLES.**—*For purposes of this part—*

(1) \* \* \*

\* \* \* \* \*

### **Subchapter S—Tax Treatment of S Corporations**

\* \* \* \* \*

## PART I—IN GENERAL

\* \* \* \* \*

## SEC. 1361. S CORPORATION DEFINED.

(a) \* \* \*

(b) SMALL BUSINESS CORPORATION.—

(1) IN GENERAL.—For purposes of this subchapter, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not—

(A) have more than **【35】** 75 shareholders,

\* \* \* \* \*

(2) INELIGIBLE CORPORATION DEFINED.—For purposes of paragraph (1), the term “ineligible corporation” means any corporation which is—

**【(A)】** a member of an affiliated group (determined under section 1504 without regard to the exceptions contained in subsection (b) thereof),

**【(B)】** (A) a financial institution to which section 585 applies (or would apply but for subsection (c) thereof) or to which section 593 applies,

**【(C)】** (B) an insurance company subject to tax under subchapter L,

**【(D)】** (C) a corporation to which an election under section 936 applies, or

**【(E)】** (D) a DISC or former DISC.

(3) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

(A) IN GENERAL.—For purposes of this title—

(i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

(B) QUALIFIED SUBCHAPTER S SUBSIDIARY.—For purposes of this paragraph, the term ‘qualified subchapter S subsidiary’ means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if—

(i) 100 percent of the stock of such corporation is held by the S corporation, and

(ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

(C) TREATMENT OF TERMINATIONS OF QUALIFIED SUBCHAPTER S SUBSIDIARY STATUS.—For purposes of this title, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of subparagraph (B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

(c) SPECIAL RULES FOR APPLYING SUBSECTION (b).—

(1) \* \* \*

(2) CERTAIN TRUSTS PERMITTED AS SHAREHOLDERS.—



(A) IN GENERAL.—For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

(i) A trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States.

(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the **60-day period** *2-year period* beginning on the day of the deemed owner's death. **¶** If a trust is described in the preceding sentence and if the entire corpus of the trust is includible in the gross estate of the deemed owner, the preceding sentence shall be applied by substituting “2-year period” for “60-day period”. **¶**

(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the **60-day period** *2-year period* beginning on the day on which such stock is transferred to it.

(iv) A trust created primarily to exercise the voting power of stock transferred to it.

(v) *An electing small business trust.*

This subparagraph shall not apply to any foreign trust.

(B) TREATMENT AS SHAREHOLDERS.—For purposes of subsection (b)(1)—

(i) In the case of a trust described in clause (i) of subparagraph (A), the deemed owner shall be treated as the shareholder.

(ii) In the case of a trust described in clause (ii) of subparagraph (A), the estate of the deemed owner shall be treated as the shareholder.

(iii) In the case of a trust described in clause (iii) of subparagraph (A), the estate of the testator shall be treated as the shareholder.

(iv) In the case of a trust described in clause (iv) of subparagraph (A), each beneficiary of the trust shall be treated as a shareholder.

(v) *In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period.*

\* \* \* \* \*

(5) STRAIGHT DEBT SAFE HARBOR.—

(A) \* \* \*

(B) STRAIGHT DEBT DEFINED.—For purposes of this paragraph, the term “straight debt” means any written unconditional promise to pay on demand or on a specified date a sum certain in money if—

(i) \* \* \*

\* \* \* \* \*

(iii) the creditor is an individual (other than a non-resident alien), an estate, **[or a trust described in paragraph (2)]** *a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money.*

**[(6) OWNERSHIP OF STOCK IN CERTAIN INACTIVE CORPORATIONS.—**For purposes of subsection (b)(2)(A), a corporation shall not be treated as a member of an affiliated group during any period within a taxable year by reason of the ownership of stock in another corporation if such other corporation—

**[(A) has not begun business at any time on or before the close of such period, and**

**[(B) does not have gross income for such period.]**

\* \* \* \* \*

(e) **ELECTING SMALL BUSINESS TRUST DEFINED.—**

(1) **ELECTING SMALL BUSINESS TRUST.—***For purposes of this section—*

(A) **IN GENERAL.—***Except as provided in subparagraph (B), the term “electing small business trust” means any trust if—*

(i) *such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, or (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c) which holds a contingent interest and is not a potential current beneficiary,*

(ii) *no interest in such trust was acquired by purchase, and*

(iii) *an election under this subsection applies to such trust.*

(B) **CERTAIN TRUSTS NOT ELIGIBLE.—***The term “electing small business trust” shall not include—*

(i) *any qualified subchapter S trust (as defined in subsection (d)(3)) if an election under subsection (d)(2) applies to any corporation the stock of which is held by such trust, and*

(ii) *any trust exempt from tax under this subtitle.*

(C) **PURCHASE.—***For purposes of subparagraph (A), the term “purchase” means any acquisition if the basis of the property acquired is determined under section 1012.*

(2) **POTENTIAL CURRENT BENEFICIARY.—***For purposes of this section, the term “potential current beneficiary” means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust. If a trust disposes of all of the stock which it holds in an S corporation, then, with respect to such corporation, the term “potential current beneficiary” does not include any person who first met the requirements of the preceding sentence during the 60-day period ending on the date of such disposition.*

(3) **ELECTION.—***An election under this subsection shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.*

## (4) CROSS REFERENCE.—

*For special treatment of electing small business trusts, see section 641(d).*

\* \* \* \* \*

## SEC. 1362. ELECTION; REVOCATION; TERMINATION.

(a) \* \* \*

(b) WHEN MADE.—

(1) \* \* \*

\* \* \* \* \*

(5) AUTHORITY TO TREAT LATE ELECTIONS, ETC., AS TIMELY.—  
If—

(A) an election under subsection (a) is made for any taxable year (determined without regard to paragraph (3)) after the date prescribed by this subsection for making such election for such taxable year or no such election is made for any taxable year, and

(B) the Secretary determines that there was reasonable cause for the failure to timely make such election, the Secretary may treat such an election as timely made for such taxable year (and paragraph (3) shall not apply).

\* \* \* \* \*

(d) TERMINATION.—

(1) \* \* \*

\* \* \* \* \*

(3) WHERE PASSIVE INVESTMENT INCOME EXCEEDS 25 PERCENT OF GROSS RECEIPTS FOR 3 CONSECUTIVE TAXABLE YEARS AND CORPORATION HAS **【SUBCHAPTER C】** ACCUMULATED EARNINGS AND PROFITS.—

(A) TERMINATION.—

(i) IN GENERAL.—An election under subsection (a) shall be terminated whenever the corporation—

(I) has **【subchapter C】** accumulated earnings and profits at the close of each of 3 consecutive taxable years, and

**【(B) SUBCHAPTER C EARNINGS AND PROFITS.—**For purposes of subparagraph (A), the term “subchapter C earnings and profits” means earnings and profits of any corporation for any taxable year with respect to which an election under section 1362(a) (or under section 1372 of prior law) was not in effect.**】**

**【(C)】** (B) GROSS RECEIPTS FROM SALES OF CAPITAL ASSETS (OTHER THAN STOCK AND SECURITIES).—For purposes of this paragraph, in the case of dispositions of capital assets (other than stock and securities), gross receipts from such dispositions shall be taken into account only to the extent of the capital gain net income therefrom.

**【(D)】** (C) PASSIVE INVESTMENT INCOME DEFINED.—For purposes of this paragraph—

(i) \* \* \*

\* \* \* \* \*

**[(E)] (D) SPECIAL RULE FOR OPTIONS AND COMMODITY DEALINGS.—**

(i) \* \* \*

\* \* \* \* \*

*(F) TREATMENT OF CERTAIN DIVIDENDS.—If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term “passive investment income” shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business.*

\* \* \* \* \*

**[(f) INADVERTENT TERMINATIONS.—If—**

**[(1) an election under subsection (a) by any corporation was terminated under paragraph (2) or (3) of subsection (d),**

**[(2) the Secretary determines that the termination was inadvertent,**

**[(3) no later than a reasonable period of time after discovery of the event resulting in such termination, steps were taken so that the corporation is once more a small business corporation, and**

**[(4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,**

**then, notwithstanding the terminating event, such corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.]**

**(f) INADVERTENT INVALID ELECTIONS OR TERMINATIONS.—If—**

**(1) an election under subsection (a) by any corporation—**

**(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or**

**(B) was terminated under paragraph (2) or (3) of subsection (d),**

**(2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent,**

**(3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken—**

**(A) so that the corporation is a small business corporation, or**

**(B) to acquire the required shareholder consents, and**

**(4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,**

*then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.*

\* \* \* \* \*

## PART II—TAX TREATMENT OF SHAREHOLDERS

\* \* \* \* \*

### SEC. 1366. PASS-THRU OF ITEMS TO SHAREHOLDERS.

#### (a) DETERMINATION OF SHAREHOLDER'S TAX LIABILITY.—

(1) IN GENERAL.—In determining the tax under this chapter of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends (or for the final taxable year of a shareholder who dies, *or of a trust or estate which terminates*, before the end of the corporation's taxable year), there shall be taken into account the shareholder's pro rata share of the corporation's—

(A) \* \* \*

\* \* \* \* \*

#### (d) SPECIAL RULES FOR LOSSES AND DEDUCTIONS.—

(1) CANNOT EXCEED SHAREHOLDER'S BASIS IN STOCK AND DEBT.—The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of—

(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to **[paragraph (1)] paragraphs (1) and (2)(A)** of section 1367(a) for the taxable year), and

\* \* \* \* \*

(3) CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS TO POST-TERMINATION TRANSITION PERIOD.—

(A) \* \* \*

\* \* \* \* \*

(D) *AT-RISK LIMITATIONS.—To the extent that any increase in adjusted basis described in subparagraph (B) would have increased the shareholder's amount at risk under section 465 if such increase had occurred on the day preceding the commencement of the post-termination transition period, rules similar to the rules described in subparagraphs (A) through (C) shall apply to any losses disallowed by reason of section 465(a).*

\* \* \* \* \*

#### **[(g) CROSS REFERENCE.—**

**[For rules relating to procedures for determining the tax treatment of subchapter S items, see subchapter D of chapter 63.]**

\* \* \* \* \*

### SEC. 1367. ADJUSTMENTS TO BASIS OF STOCK OF SHAREHOLDERS, ETC.

#### (a) GENERAL RULE.—

(1) \* \* \*

(2) **DECREASES IN BASIS.**—The basis of each shareholder's stock in an S corporation shall be decreased for any period (but not below zero) by the sum of the following items determined with respect to the shareholder for such period:

(A) \* \* \*

\* \* \* \* \*

(E) the amount of the shareholder's deduction for depletion for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder under [section 613A(c)(13)(B)] section 613A(c)(11)(B).

(b) **SPECIAL RULES.**—

(1) \* \* \*

\* \* \* \* \*

(4) **ADJUSTMENTS IN CASE OF INHERITED STOCK.**—

(A) **IN GENERAL.**—If any person acquires stock in an S corporation by reason of the death of a decedent or by bequest, devise, or inheritance, section 691 shall be applied with respect to any item of income of the S corporation in the same manner as if the decedent had held directly his pro rata share of such item.

(B) **ADJUSTMENTS TO BASIS.**—The basis determined under section 1014 of any stock in an S corporation shall be reduced by the portion of the value of the stock which is attributable to items constituting income in respect of the decedent.

\* \* \* \* \*

#### **SEC. 1368. DISTRIBUTIONS.**

(a) \* \* \*

\* \* \* \* \*

(d) **CERTAIN ADJUSTMENTS TAKEN INTO ACCOUNT.**—Subsections (b) and (c) shall be applied by taking into account (to the extent proper)—

(1) the adjustments to the basis of the shareholder's stock described in section 1367, and

(2) the adjustments to the accumulated adjustments account which are required by subsection (e)(1).

*In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year.*

(e) **DEFINITIONS AND SPECIAL RULES.**—For purposes of this section—

(1) **ACCUMULATED ADJUSTMENTS ACCOUNT.**—

(A) **IN GENERAL.**—Except [as provided in subparagraph (B)] as otherwise provided in this paragraph, the term “accumulated adjustments account” means an account of the S corporation which is adjusted for the S period in a manner similar to the adjustments under section 1367 (except that no adjustment shall be made for income (and related

expenses) which is exempt from tax under this title and the phrase “(but not below zero)” shall be disregarded in **[section 1367(b)(2)(A)]** *section 1367(a)(2)*) and no adjustment shall be made for Federal taxes attributable to any taxable year in which the corporation was a C corporation.

\* \* \* \* \*

**(C) NET LOSS FOR YEAR DISREGARDED.—**

*(i) IN GENERAL.—In applying this section to distributions made during any taxable year, the amount in the accumulated adjustments account as of the close of such taxable year shall be determined without regard to any net negative adjustment for such taxable year.*

*(ii) NET NEGATIVE ADJUSTMENT.—For purposes of clause (i), the term “net negative adjustment” means, with respect to any taxable year, the excess (if any) of—*

*(I) the reductions in the account for the taxable year (other than for distributions), over*

*(II) the increases in such account for such taxable year.*

\* \* \* \* \*

### **PART III—SPECIAL RULES**

Sec. 1371. Coordination with subchapter C.

\* \* \* \* \*

Sec. 1375. Tax imposed when passive investment income of corporation having **[subchapter C]** *accumulated* earnings and profits exceeds 25 percent of gross receipts.

\* \* \* \* \*

#### **SEC. 1371. COORDINATION WITH SUBCHAPTER C.**

**[(a) APPLICATION OF SUBCHAPTER C RULES.—**

**[(1) IN GENERAL.—**Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.

**[(2) S CORPORATION AS SHAREHOLDER TREATED LIKE INDIVIDUAL.—**For purposes of subchapter C, an S corporation in its capacity as a shareholder of another corporation shall be treated as an individual.]

*(a) APPLICATION OF SUBCHAPTER C RULES.—Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.*

\* \* \* \* \*

#### **SEC. 1375. TAX IMPOSED WHEN PASSIVE INVESTMENT INCOME OF CORPORATION HAVING [SUBCHAPTER C] ACCUMULATED EARNINGS AND PROFITS EXCEEDS 25 PERCENT OF GROSS RECEIPTS.**

**(a) GENERAL RULE.—**If for the taxable year an S corporation has—

(1) **【subchapter C】** *accumulated* earnings and profits at the close of such taxable year, and

\* \* \* \*

(b) **DEFINITIONS.**—For purposes of this section—

(1) \* \* \*

\* \* \* \*

**【(3) PASSIVE INVESTMENT INCOME; ETC.**—The terms “subchapter C earnings and profits”, “passive investment income”, and “gross receipts” shall have the same respective meanings as when used in paragraph (3) of section 1362(d).**】**

*(3) PASSIVE INVESTMENT INCOME, ETC.—The terms “passive investment income” and “gross receipts” have the same respective meanings as when used in paragraph (3) of section 1362(d).*

\* \* \* \*

#### **PART IV—DEFINITIONS; MISCELLANEOUS**

\* \* \* \*

#### **SEC. 1377. DEFINITIONS AND SPECIAL RULE.**

(a) **PRO RATA SHARE.**—For purposes of this subchapter—

(1) \* \* \*

**【(2) ELECTION TO TERMINATE YEAR.**—Under regulations prescribed by the Secretary, if any shareholder terminates his interest in the corporation during the taxable year and all persons who are shareholders during the taxable year agree to the application of this paragraph, paragraph (1) shall be applied as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.**】**

*(2) ELECTION TO TERMINATE YEAR.—*

*(A) IN GENERAL.—Under regulations prescribed by the Secretary, if any shareholder terminates the shareholder’s interest in the corporation during the taxable year and all affected shareholders and the corporation agree to the application of this paragraph, paragraph (1) shall be applied to the affected shareholders as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.*

*(B) AFFECTED SHAREHOLDERS.—For purposes of subparagraph (A), the term “affected shareholders” means the shareholder whose interest is terminated and all shareholders to whom such shareholder has transferred shares during the taxable year. If such shareholder has transferred shares to the corporation, the term “affected shareholders” shall include all persons who are shareholders during the taxable year.*

(b) **POST-TERMINATION TRANSITION PERIOD.**—

(1) **IN GENERAL.**—For purposes of this subchapter, the term “post-termination transition period” means—

(A) the period beginning on the day after the last day of the corporation’s last taxable year as an S corporation and ending on the later of—

(i) the day which is 1 year after such last day, or



(ii) the due date for filing the return for such last year as an S corporation (including extensions), **[and]** *(B) the 120-day period beginning on the date of any determination pursuant to an audit of the taxpayer which follows the termination of the corporation's election and which adjusts a subchapter S item of income, loss, or deduction of the corporation arising during the S period (as defined in section 1368(e)(2)), and*

**[(B)]** *(C) the 120-day period beginning on the date of a determination that the corporation's election under section 1362(a) had terminated for a previous taxable year.*

(2) DETERMINATION DEFINED.—For purposes of paragraph (1), the term “determination” means—

**[(A)]** a court decision which becomes final,

**[(B)]** a closing agreement, or

*(A) a determination as defined in section 1313(a), or*

**[(C)]** *(B) an agreement between the corporation and the Secretary that the corporation failed to qualify as an S corporation.*

\* \* \* \* \*

## Subchapter U—Designation and Treatment of Empowerment Zones, Enterprise Communities, and Rural Development Investment Areas

\* \* \* \* \*

## PART II—TAX-EXEMPT FACILITY BONDS FOR EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES

\* \* \* \* \*

### SEC. 1394. TAX-EXEMPT ENTERPRISE ZONE FACILITY BONDS.

(a) \* \* \*

\* \* \* \* \*

(e) PENALTY FOR CEASING TO MEET REQUIREMENTS.—

(1) \* \* \*

(2) LOSS OF DEDUCTIONS WHERE FACILITY CEASES TO BE QUALIFIED.—No deduction shall be allowed under this chapter for interest on any financing provided from any bond to which subsection (a) applies with respect to any facility to the extent such interest accrues during the period beginning on the first day of the calendar year which includes the date on which—

**[(i)]** *(A) substantially all of the facility with respect to which the financing was provided ceases to be used in an empowerment zone or enterprise community, or*

**[(ii)]** *(B) the principal user of such facility ceases to be an enterprise zone business (as defined in subsection (b)).*

\* \* \* \* \*

**PART III—ADDITIONAL INCENTIVES FOR  
EMPOWERMENT ZONES**

\* \* \* \* \*

**Subpart A—Empowerment Zone Employment Credit**

\* \* \* \* \*

**SEC. 1396. EMPOWERMENT ZONE EMPLOYMENT CREDIT.**

(a) \* \* \*

\* \* \* \* \*

(c) **QUALIFIED ZONE WAGES.**—

(1) \* \* \*

\* \* \* \* \*

(3) **COORDINATION WITH [TARGETED JOBS CREDIT] WORK OPPORTUNITY CREDIT.**—

(A) **IN GENERAL.**—The term “qualified zone wages” shall not include wages taken into account in determining the credit under section 51.

\* \* \* \* \*

**Subpart B—Additional Expensing**

\* \* \* \* \*

**SEC. 1397B. ENTERPRISE ZONE BUSINESS DEFINED.**

(a) \* \* \*

\* \* \* \* \*

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

(1) \* \* \*

\* \* \* \* \*

(5) **CERTAIN BUSINESSES EXCLUDED.**—The term “qualified business” shall not include—

(A) any trade or business consisting of the operation of any facility described in section 144(c)(6)(B), and

(B) any trade or business the principal activity of which is farming (within the meaning of subparagraphs (A) or (B) of section 2032A(e)(5)), but only if, as of the close of the [preceding] taxable year, the sum of—

(i) the aggregate unadjusted bases (or, if greater, the fair market value) of the assets owned by the taxpayer which are used in such a trade or business, and

(ii) the aggregate value of assets leased by the taxpayer which are used in such a trade or business, exceeds \$500,000.

For purposes of subparagraph (B), rules similar to the rules of section 1397(b) shall apply.

\* \* \* \* \*

## CHAPTER 2—TAX ON SELF-EMPLOYMENT INCOME

\* \* \* \* \*

### 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) \* \* \*

\* \* \* \* \*

(8) an individual who is a duly ordained, commissioned, or licensed minister of a church or a member of a religious order shall compute his net earnings from self-employment derived from the performance of service described in subsection (c)(4) without regard to section 107 (relating to rental value of parsonages), section 119 (relating to meals and lodging furnished for the convenience of the employer), and section 911 (relating to citizens or residents of the United States living abroad), *but shall not include in such net earnings from self-employment the rental value of any parsonage (whether or not excludable under section 107) provided after the individual retires, or any other retirement benefit received by such individual from a church plan (as defined in section 414(e)) after the individual retires;*

\* \* \* \* \*

## CHAPTER 3—WITHHOLDING OF TAX ON NON- RESIDENT ALIENS AND FOREIGN CORPORA- TIONS

\* \* \* \* \*

### Subchapter A—Nonresident Aliens and Foreign Corporations

\* \* \* \* \*

### SEC. 1445. WITHHOLDING OF TAX ON DISPOSITIONS OF UNITED STATES REAL PROPERTY INTERESTS.

(a) \* \* \*

\* \* \* \* \*

(e) **SPECIAL RULES RELATING TO DISTRIBUTIONS, ETC., BY CORPORATIONS, PARTNERSHIPS, TRUSTS, OR ESTATES.**—

(1) \* \* \*

\* \* \* \* \*

(3) DISTRIBUTIONS BY CERTAIN DOMESTIC CORPORATIONS TO FOREIGN SHAREHOLDERS.—If a domestic corporation which is or has been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii) distributes property to a foreign person in a transaction to which section 302 or part II of subchapter C applies, such corporation shall deduct and withhold under subsection (a) a tax equal to 10 percent of the amount realized by the foreign shareholder. The preceding sentence shall not apply if, as of the date of the distribution, interests in such corporation are not United States real property interests by reason of section 897(c)(1)(B). *Rules similar to the rules of the preceding provisions of this paragraph shall apply in the case of any distribution to which section 301 applies and which is not made out of the earnings and profits of such a domestic corporation.*

\* \* \* \* \*

## Subchapter B—Application of Withholding Provisions

\* \* \* \* \*

### SEC. 1463. TAX PAID BY RECIPIENT OF INCOME.

If—

(1) any person, in violation of the provisions of this chapter, fails to deduct and withhold any tax under this chapter, and

(2) thereafter the tax against which such tax may be credited is paid,

the tax so required to be deducted and withheld shall not be collected from such person; but this [subsection] *section* shall in no case relieve such person from liability for interest or any penalties or additions to the tax otherwise applicable in respect of such failure to deduct and withhold.

\* \* \* \* \*

## CHAPTER 6—CONSOLIDATED RETURNS

\* \* \* \* \*

### Subchapter A—Returns and Payment of Tax

\* \* \* \* \*

### SEC. 1504. DEFINITIONS.

(a) \* \* \*

(b) DEFINITION OF “INCLUDIBLE CORPORATION”.—As used in this chapter, the term “includible corporation” means any corporation except—

(1) \* \* \*

\* \* \* \* \*

(8) *An S corporation.*

(c) INCLUDIBLE INSURANCE COMPANIES.—Notwithstanding the provisions of paragraph (2) of subsection (b)—

(1) \* \* \*

(2)(A) \* \* \*

(B) IF AN ELECTION UNDER THIS PARAGRAPH IS IN EFFECT FOR A TAXABLE YEAR.—

(i) section 243(b)(3) and the exception provided under section 243(b)(2) with respect to subsections (b)(2) and (c) of this section,

\* \* \* \* \*

## Subchapter B—Related Rules

\* \* \* \* \*

## PART II—CERTAIN CONTROLLED CORPORATIONS

\* \* \* \* \*

### SEC. 1561. LIMITATIONS ON CERTAIN MULTIPLE TAX BENEFITS IN THE CASE OF CERTAIN CONTROLLED CORPORATIONS.

(a) GENERAL RULE.—The component members of a controlled group of corporations on a December 31 shall, for their taxable years which include such December 31, be limited for purposes of this subtitle to—

(1) amounts in each taxable income bracket in the tax table in section 11(b)(1) which do not aggregate more than the maximum amount in such bracket to which a corporation which is not a component member of a controlled group is entitled,

(2) one \$250,000 (\$150,000 if any component member is a corporation described in section 535(c)(2)(B)) amount for purposes of computing the accumulated earnings credit under section 535(c)(2) and (3),

(3) one \$40,000 exemption amount for purposes of computing the amount of the minimum tax, and

(4) one \$2,000,000 amount for purposes of computing the tax imposed by section 59A.

The amounts specified in paragraph (1), the amount specified in paragraph (3), and the amount specified in paragraph (4) shall be divided equally among the component members of such group on such December 31 unless all of such component members consent (at such time and in such manner as the Secretary shall by regulations prescribe) to an apportionment plan providing for an unequal allocation of such amounts. The amounts specified in paragraph (2) shall be divided equally among the component members of such group on such December 31 unless the Secretary prescribes regulations permitting an unequal allocation of such amounts. Notwithstanding paragraph (1), in applying the [last sentence] *last 2 sentences* of section 11(b)(1) to such component members, the taxable income of all such component members shall be taken into account and any increase in tax under such [last sentence] *last 2 sentences* shall be divided among such component members in the same manner as amounts under paragraph (1). In applying section 55(d)(3), the alternative minimum taxable income of all component members shall be taken into account and any decrease in the exemption

amount shall be allocated to the component members in the same manner as under paragraph (3).

\* \* \* \* \*

## Subtitle B—Estate and Gift Taxes

\* \* \* \* \*

### CHAPTER 11—ESTATE TAX

\* \* \* \* \*

#### Subchapter B—Estates of Nonresidents Not Citizens

\* \* \* \* \*

#### SEC. 2102. CREDITS AGAINST TAX.

(a) \* \* \*

\* \* \* \* \*

(c) UNIFIED CREDIT.—

(1) \* \* \*

\* \* \* \* \*

(3) SPECIAL RULES.—

(A) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to \$192,800 as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. *For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.*

\* \* \* \* \*

#### SEC. 2104. PROPERTY WITHIN THE UNITED STATES.

(a) \* \* \*

\* \* \* \* \*

(c) DEBT OBLIGATIONS.—For purposes of this subchapter, debt obligations of—

(1) a United States person, or

(2) the United States, a State or any political subdivision thereof, or the District of Columbia,

owned and held by a nonresident not a citizen of the United States shall be deemed property within the United States. With respect to estates of decedents dying after December 31, 1969, deposits with a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business, shall, for purposes of this subchapter, be deemed property within the United States. This

subsection shall not apply to a debt obligation to which section 2105(b) applies or to a debt obligation of a domestic corporation if any interest on such obligation, were such interest received by the decedent at the time of his death, would be treated by reason of **【subparagraph (A), (C), or (D) of section 861(a)(1)】** *section 861(a)(1)(A)* as income from sources without the United States.

\* \* \* \* \*

## CHAPTER 14—SPECIAL VALUATION RULES

\* \* \* \* \*

### SEC. 2701. SPECIAL VALUATION RULES IN CASE OF TRANSFERS OF CERTAIN INTERESTS IN CORPORATIONS OR PARTNERSHIPS.

#### (a) VALUATION RULES.—

##### (1) \* \* \*

\* \* \* \* \*

##### (3) VALUATION OF RIGHTS TO WHICH PARAGRAPH APPLIES.—

(A) IN GENERAL.—The value of any right described in paragraph (1), other than a distribution right which consists of a right to receive a qualified payment, shall be treated as being zero.

##### (B) VALUATION OF CERTAIN QUALIFIED PAYMENTS.—If—

(i) any applicable retained interest confers a distribution right which consists of the right to a qualified payment, and

(ii) there are 1 or more liquidation, put, call, or conversion rights with respect to such interest, the value of all such rights shall be determined as if each liquidation, put, call, or conversion right were exercised in the manner resulting in the lowest value being determined for all such rights.

(C) VALUATION OF QUALIFIED PAYMENTS WHERE NO LIQUIDATION, ETC. RIGHTS.—*In the case of an applicable retained interest which is described in subparagraph (B)(i) but not subparagraph (B)(ii), the value of the distribution right shall be determined without regard to this section.*

##### (4) MINIMUM VALUATION OF JUNIOR EQUITY.—

(A) IN GENERAL.—In the case of a transfer described in paragraph (1) of a junior equity interest in a corporation or partnership, such interest shall in no event be valued at an amount less than the value which would be determined if the total value of all of the junior equity interests in the entity were equal to 10 percent of the sum of—

(i) the total value of all of the equity interests in such entity, plus

(ii) the total amount of indebtedness of such entity to the transferor (or an applicable family member).

##### (B) DEFINITIONS.—For purposes of this paragraph—

(i) JUNIOR EQUITY INTEREST.—The term “junior equity interest” means common stock or, in the case of a partnership, any partnership interest under which the rights as to income and capital (*or, to the extent*

*provided in regulations, the rights as to either income or capital*) are junior to the rights of all other classes of equity interests.

(ii) **EQUITY INTEREST.**—The term “equity interest” means stock or any interest as a partner, as the case may be.

(b) **APPLICABLE RETAINED INTERESTS.**—For purposes of this section—

(1) **IN GENERAL.**—The term “applicable retained interest” means any interest in an entity with respect to which there is—

(A) a distribution right, but only if, immediately before the transfer described in subsection (a)(1), the transferor and applicable family members hold (after application of subsection (e)(3)) control of the entity, or

(B) a liquidation, put, call, or conversion right.

(2) **CONTROL.**—For purposes of paragraph (1)—

(A) **CORPORATIONS.**—In the case of a corporation, the term “control” means the holding of at least 50 percent (by vote or value) of the stock of the corporation.

(B) **PARTNERSHIPS.**—In the case of a partnership, the term “control” means—

(i) the holding of at least 50 percent of the capital or profits interests in the partnership, or

(ii) in the case of a limited partnership, the holding of any interest as a general partner.

(C) **APPLICABLE FAMILY MEMBER.**—For purposes of this subsection, the term “applicable family member” includes any lineal descendant of any parent of the transferor or the transferor’s spouse.

(c) **DISTRIBUTION AND OTHER RIGHTS; QUALIFIED PAYMENTS.**—For purposes of this section—

(1) **DISTRIBUTION RIGHT.**—

(A) **IN GENERAL.**—The term “distribution right” means—

(i) a right to distributions from a corporation with respect to its stock, and

(ii) a right to distributions from a partnership with respect to a partner’s interest in the partnership.

(B) **EXCEPTIONS.**—The term “distribution right” does not include—

[(i) a right to distributions with respect to any junior equity interest (as defined in subsection (a)(4)(B)(i)),]

(i) a right to distributions with respect to any interest which is junior to the rights of the transferred interest,

(ii) any liquidation, put, call, or conversion right, or

(iii) any right to receive any guaranteed payment described in section 707(c) of a fixed amount.

\* \* \* \* \*

(3) **QUALIFIED PAYMENT.**—

(A) **IN GENERAL.**—Except as otherwise provided in this paragraph, the term “qualified payment” means any dividend payable on a periodic basis under any cumulative preferred stock (or a comparable payment under any part-



nership interest) to the extent that such dividend (or comparable payment) is determined at a fixed rate.

(B) TREATMENT OF VARIABLE RATE PAYMENTS.—For purposes of subparagraph (A), a payment shall be treated as fixed as to rate if such payment is determined at a rate which bears a fixed relationship to a specified market interest rate.

(C) ELECTIONS.—

[(i) WAIVER OF QUALIFIED PAYMENT TREATMENT.—A transferor or applicable family member may elect with respect to payments under any interest specified in such election to treat such payments as payments which are not qualified payments.]

(i) *IN GENERAL.*—*Payments under any interest held by a transferor which (without regard to this subparagraph) are qualified payments shall be treated as qualified payments unless the transferor elects not to treat such payments as qualified payments. Payments described in the preceding sentence which are held by an applicable family member shall be treated as qualified payments only if such member elects to treat such payments as qualified payments.*

(ii) ELECTION TO HAVE INTEREST TREATED AS QUALIFIED PAYMENT.—[A transferor or any applicable family member may elect to treat any distribution right as a qualified payment, to be paid in the amounts and at the times specified in such election.] *A transferor or applicable family member holding any distribution right which (without regard to this subparagraph) is not a qualified payment may elect to treat such right as a qualified payment, to be paid in the amounts and at the times specified in such election. The preceding sentence shall apply only to the extent that the amounts and times so specified are not inconsistent with the underlying legal instrument giving rise to such right.*

(iii) ELECTIONS IRREVOCABLE.—Any election under this subparagraph with respect to an interest shall, once made, be irrevocable.

(d) TRANSFER TAX TREATMENT OF CUMULATIVE BUT UNPAID DISTRIBUTIONS.—

(1) *IN GENERAL.*—If a taxable event occurs with respect to any distribution right to which [subsection (a)(3)(B)] *subsection (a)(3) (B) or (C)* applied, the following shall be increased by the amount determined under paragraph (2):

\* \* \* \* \*

(3) TAXABLE EVENTS.—For purposes of this subsection—

(A) *IN GENERAL.*—The term “taxable event” means any of the following:

(i) The death of the transferor if the applicable retained interest conferring the distribution right is includible in the estate of the transferor.

(ii) The transfer of such applicable retained interest.

(iii) At the election of the taxpayer, the payment of any qualified payment after the period described in paragraph (2)(C), but only with respect to **the period ending on the date of** such payment.

**(B) EXCEPTION WHERE SPOUSE IS TRANSFEREE.—**

(i) **DEATHTIME TRANSFERS.**—Subparagraph (A)(i) shall not apply to any interest includible in the gross estate of the transferor if a deduction with respect to such interest is allowable under section 2056 or 2106(a)(3).

(ii) **LIFETIME TRANSFERS.**—A transfer to the spouse of the transferor shall not be treated as a taxable event under subparagraph (A)(ii) if such transfer does not result in a taxable gift by reason of—

(I) any deduction allowed under section 2523, *or the exclusion under section 2503(b)*, or

(II) consideration for the transfer provided by the spouse.

(iii) **SPOUSE SUCCEEDS TO TREATMENT OF TRANSFEROR.**—If an event is not treated as a taxable event by reason of this subparagraph, the transferee spouse or surviving spouse (as the case may be) shall be treated in the same manner as the transferor in applying this subsection with respect to the interest involved.

**(4) SPECIAL RULES FOR APPLICABLE FAMILY MEMBERS.—**

(A) **FAMILY MEMBER TREATED IN SAME MANNER AS TRANSFEROR.**—For purposes of this subsection, an applicable family member shall be treated in the same manner as the transferor with respect to any distribution right retained by such family member to which **subsection (a)(3)(B)** *subsection (a)(3) (B) or (C)* applied.

(B) **TRANSFER TO APPLICABLE FAMILY MEMBER.**—In the case of a taxable event described in paragraph (3)(A)(ii) involving the transfer of an applicable retained interest to an applicable family member (other than the spouse of the transferor), the applicable family member shall be treated in the same manner as the transferor in applying this subsection to distributions accumulating with respect to such interest after such taxable event.

(C) **TRANSFER TO TRANSFERORS.**—*In the case of a taxable event described in paragraph (3)(A)(ii) involving a transfer of an applicable retained interest from an applicable family member to a transferor, this subsection shall continue to apply to the transferor during any period the transferor holds such interest.*

(5) **TRANSFER TO INCLUDE TERMINATION.**—For purposes of this subsection, any termination of an interest shall be treated as a transfer.

(e) **OTHER DEFINITIONS AND RULES.**—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

**[(3) CONTRIBUTION RULES.—**

[(A) INDIRECT HOLDINGS AND TRANSFERS.—AN INDIVIDUAL]

(3) *ATTRIBUTION OF INDIRECT HOLDINGS AND TRANSFERS.*—An individual shall be treated as holding any interest to the extent such interest is held indirectly by such individual through a corporation, partnership, trust, or other entity. If any individual is treated as holding any interest by reason of the preceding sentence, any transfer which results in such interest being treated as no longer held by such individual shall be treated as a transfer of such interest.

[(B) CONTROL.—For purposes of subsections (b)(1), an individual shall be treated as holding any interest held by the individual's brothers, sisters, or lineal descendants.]

(4) *EFFECT OF ADOPTION.*—A relationship by legal adoption shall be treated as a relationship by blood.

(5) *CERTAIN CHANGES TREATED AS TRANSFERS.*—Except as provided in regulations, a contribution to capital or a redemption, recapitalization, or other change in the capital structure of a corporation or partnership shall be treated as a transfer of an interest in such entity to which this section applies if the taxpayer or an applicable family member—

(A) receives an applicable retained interest in such entity pursuant to [such contribution to capital or such redemption, recapitalization, or other change] *such transaction, or*

(B) under regulations, otherwise holds, immediately after [the transfer] *such transaction*, an applicable retained interest in such entity.

This paragraph shall not apply to any transaction (other than a contribution to capital) if the interests in the entity held by the transferor, applicable family members, and members of the transferor's family before and after the transaction are substantially identical.

(6) *ADJUSTMENTS.*—Under regulations prescribed by the Secretary, if there is any subsequent transfer, or inclusion in the gross estate, of any applicable retained interest which was valued under the rules of subsection (a), appropriate adjustments shall be made for purposes of chapter 11, 12, or 13 to reflect the increase in the amount of any prior taxable gift made by the transferor or decedent by reason of such valuation *or to reflect the application of subsection (d).*

(7) *TREATMENT AS SEPARATE INTERESTS.*—The Secretary may by regulation provide that any applicable retained interest shall be treated as 2 or more separate interests for purposes of this section.

\* \* \* \* \*

**SEC. 2702. SPECIAL VALUATION RULES IN CASE OF TRANSFERS OF INTERESTS IN TRUSTS.**

(a) *VALUATION RULES.*—

(1) \* \* \*

\* \* \* \* \*

(3) *EXCEPTIONS.*—

(A) IN GENERAL.—This subsection shall not apply to any transfer—

(i) [to the extent] *if* such transfer is an [incomplete transfer] *incomplete gift*, [or]

(ii) if such transfer involves the transfer of an interest in trust all the property in which consists of a residence to be used as a personal residence by persons holding term interests in such trust[.], or

(iii) *to the extent that regulations provide that such transfer is not inconsistent with the purposes of this section.*

(B) [INCOMPLETE TRANSFER] *INCOMPLETE GIFT*.—For purposes of subparagraph (A), the term “[incomplete transfer] *incomplete gift*” means any transfer which would not be treated as a gift whether or not consideration was received for such transfer.

\* \* \* \* \*

#### SEC. 2704. TREATMENT OF CERTAIN LAPSING RIGHTS AND RESTRICTIONS.

(a) \* \* \*

\* \* \* \* \*

(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(3) ATTRIBUTION.—The rule of section [2701(e)(3)(A)] 2701(e)(3) shall apply for purposes of determining the interests held by any individual.

\* \* \* \* \*

### Subtitle C—Employment Taxes

\* \* \* \* \*

## CHAPTER 21—FEDERAL INSURANCE CONTRIBUTIONS ACT

\* \* \* \* \*

### Subchapter C—General Provisions

\* \* \* \* \*

#### SEC. 3121. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) \* \* \*

\* \* \* \* \*

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) \* \* \*

\* \* \* \* \*

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974, **[or]**

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received;  
or

(H) *under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof,*

\* \* \* \* \*

(b) EMPLOYMENT.—For purposes of this chapter, the term “employment” means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee for an American employer (as defined in subsection (h)), or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agreement entered into under section 233 of the Social Security Act; except that such term shall not include—

(1) \* \* \*

\* \* \* \* \*

(20) service (other than service described in paragraph (3)(A)) performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

**[(A) such individual does not receive any cash remuneration (other than as provided in subparagraph (B)),]**

*(A) such individual does not receive any cash remuneration other than as provided in subparagraph (B) and other than cash remuneration—*

*(i) which does not exceed \$100 per trip;*

- (ii) which is contingent on a minimum catch; and
- (iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,

\* \* \* \* \*

*For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.*

\* \* \* \* \*

## CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

\* \* \* \* \*

### SEC. 3306. DEFINITIONS.

(a) \* \* \*

(b) **WAGES.**—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) \* \* \*

\* \* \* \* \*

(5) any payment made to, or on behalf of, an employee or his beneficiary—

(A) \* \* \*

\* \* \* \* \*

(F) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this paragraph to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974; **[or]**

(G) under a cafeteria plan (within the meaning of section 125) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received,

or

(H) under an arrangement to which section 408(p) applies, other than any elective contributions under paragraph (2)(A)(i) thereof,

\* \* \* \* \*

(c) **EMPLOYMENT.**—For purposes of this chapter, the term “employment” means any service performed prior to 1955, which was employment for purposes of subchapter C of chapter 9 of the Internal Revenue Code of 1939 under the law applicable to the period in which such service was performed, and (A) any service, of whatever nature, performed after 1954 by an employee for the person

employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, and (B) any service, of whatever nature, performed after 1971 outside the United States (except in a contiguous country with which the United States has an agreement relating to unemployment compensation) by a citizen of the United States as an employee of an American employer (as defined in subsection (j)(3)), except—

(1) agricultural labor (as defined in subsection (k)) unless—

(A) \* \* \*

(B) such labor is not agricultural labor performed [before January 1, 1995,] by an individual who is an alien admitted to the United States to perform agricultural labor pursuant to sections 214(c) and 101(a)(15)(H) of the Immigration and Nationality Act;

\* \* \* \* \*

(k) AGRICULTURAL LABOR.—For purposes of this chapter, the term “agricultural labor” has the meaning assigned to such term by subsection (g) of section 3121, except that for purposes of this chapter subparagraph (B) of paragraph (4) of such subsection (g) shall be treated as reading:

“(B) in the employ of a group of operators of farms (or a cooperative organization of which such operators are members) in the performance of service described in subparagraph (A), but only if such if such operators produced more than one-half of the commodity with respect to which such service is performed;”.

\* \* \* \* \*

## CHAPTER 24—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

\* \* \* \* \*

### SEC. 3401. DEFINITIONS.

(a) WAGES.—For purposes of this chapter, the term “wages” means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include remuneration paid—

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating to certain [combat pay] *combat zone compensation* of members of the Armed Forces of the United States) to the extent remuneration for such service is excludable from gross income under such section; or

\* \* \* \* \*

(12) to, or on behalf of, an employee or his beneficiary—

(A) from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(D) *under an arrangement to which section 408(p) applies; or*

\* \* \* \* \*

#### **SEC. 3405. SPECIAL RULES FOR PENSIONS, ANNUITIES, AND CERTAIN OTHER DEFERRED INCOME.**

(a) \* \* \*

\* \* \* \* \*

(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

(12) FAILURE TO PROVIDE CORRECT TIN.—If—

(A) a payee fails to furnish his TIN to the payor in the manner required by the Secretary, or

(B) the Secretary notifies the payor before any payment or distribution that the TIN furnished by the payee is incorrect, no election under subsection (a)(2) or [(b)(3)] (b)(2) shall be treated as in effect and subsection (a)(4) shall not apply to such payee.

\* \* \* \* \*

### **Subtitle D—Miscellaneous Excise Taxes**

\* \* \* \* \*

#### **CHAPTER 31—RETAIL EXCISE TAXES**

\* \* \* \* \*

#### **Subchapter A—Luxury Passenger Automobiles**

\* \* \* \* \*

#### **SEC. 4001. IMPOSITION OF TAX.**

(a) \* \* \*

\* \* \* \* \*

[(e) INFLATION ADJUSTMENT.—

[(1) IN GENERAL.—If, for any calendar year, the excess (if any) of—



[(A) \$30,000, increased by the cost-of-living adjustment for the calendar year, over

[(B) the dollar amount in effect under subsection (a) for the calendar year,

is equal to or greater than \$2,000, then the \$30,000 amount in subsection (a) and section 4003(a) (as previously adjusted under this subsection) for any subsequent calendar year shall be increased by the amount of such excess rounded to the next lowest multiple of \$2,000.

[(2) COST-OF-LIVING ADJUSTMENT.—For purposes of paragraph (1), the cost-of-living adjustment for any calendar year shall be the cost-of-living adjustment under section 1(f)(3) for such calendar year, determined by substituting “calendar year 1990” for “calendar year 1992” in subparagraph (B) thereof.]

(e) INFLATION ADJUSTMENT.—

(1) IN GENERAL.—The \$30,000 amount in subsection (a) and section 4003(a) shall be increased by an amount equal to—

(A) \$30,000, multiplied by

(B) the cost-of-living adjustment under section 1(f)(3) for the calendar year in which the vehicle is sold, determined by substituting “calendar year 1990” for “calendar year 1992” in subparagraph (B) thereof.

(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of \$2,000, such amount shall be rounded to the next lowest multiple of \$2,000.

\* \* \* \* \*

## CHAPTER 36—FACILITIES AND SERVICES

\* \* \* \* \*

### Subchapter A—Harbor Maintenance Tax

\* \* \* \* \*

#### SEC. 4462. DEFINITIONS AND SPECIAL RULES.

(a) \* \* \*

(b) SPECIAL RULE FOR ALASKA, HAWAII, AND POSSESSIONS.—

(1) IN GENERAL.—No tax shall be imposed under section 4461(a) with respect to—

(A) \* \* \*

\* \* \* \* \*

(D) cargo loaded on a vessel in Alaska, Hawaii, or a possession of the United States and unloaded in the State or possession in which loaded, or passengers transported on United States flag vessels operating solely within the State waters of Alaska or Hawaii and adjacent international waters.

\* \* \* \* \*

## Subchapter B—Transportation by Water

\* \* \* \* \*

Sec. 4472. Definitions [and special rules].

\* \* \* \* \*

## CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

\* \* \* \* \*

[Sec. 4978B. Tax on disposition of employer securities to which section 133 applied.]

\* \* \* \* \*

### SEC. 4972. TAX ON NONDEDUCTIBLE CONTRIBUTIONS TO QUALIFIED EMPLOYER PLANS.

(a) \* \* \*

\* \* \* \* \*

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

(1) QUALIFIED EMPLOYER PLAN.—

(A) IN GENERAL.—The term “qualified employer plan” means—

(i) any plan meeting the requirements of section 401(a) which includes a trust exempt from tax under section 501(a),

(ii) an annuity plan described in section 403(a), [and]

(iii) any simplified employee pension (within the meaning of section 408(k)) [and], and

(iv) any simple retirement account (within the meaning of section 408(p)).

\* \* \* \* \*

### SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO INDIVIDUAL RETIREMENT ACCOUNTS, CERTAIN SECTION 403(B) CONTRACTS, AND CERTAIN INDIVIDUAL RETIREMENT ANNUITIES.

(a) \* \* \*

(b) EXCESS CONTRIBUTIONS.—For purposes of this section, in the case of individual retirement accounts or individual retirement annuities, the term “excess contributions” means the sum of—

(1) the excess (if any) of—

(A) the amount contributed for the taxable year to the accounts or for the annuities (other than a rollover contribution described in [sections 402(c)] section 402(c), 403(a)(4), 403(b)(8), or 408(d)(3)), over

\* \* \* \* \*

### SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) INITIAL TAXES ON DISQUALIFIED PERSON.—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to [5] 10 percent of the amount involved with respect to the prohibited transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by

any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

\* \* \* \* \*

(d) EXEMPTIONS.—The prohibitions provided in subsection (c) shall not apply to—

(1) \* \* \*

\* \* \* \* \*

(13) any transaction which is exempt from section 406 of such Act by reason of section 408(e) of such Act (or which would be so exempt if such section 406 applied to such transaction) or which is exempt from section 406 of such Act by reason of section ~~408(b)~~ 408(b)(12) of such Act;

\* \* \* \* \*

**SEC. 4977. TAX ON CERTAIN FRINGE BENEFITS PROVIDED BY AN EMPLOYER.**

(a) \* \* \*

\* \* \* \* \*

(c) EFFECT OF ELECTION ON SECTION 132(a).—If—

(1) an election under this section is in effect with respect to an employer for any calendar year, and

(2) at all times on or after January 1, 1984, and before the close of the calendar year involved, substantially all of the employees of the employer were entitled to employee discounts on goods or services provided by the employer in 1 line of business,

for purposes of paragraphs (1) and (2) of section 132(a) (but not for purposes of ~~section 132(i)(2)~~ section 132(h)), all employees of any line of business of the employer which was in existence on January 1, 1984, shall be treated as employees of the line of business referred to in paragraph (2).

\* \* \* \* \*

**SEC. 4978. TAX ON CERTAIN DISPOSITIONS BY EMPLOYEE STOCK OWNERSHIP PLANS AND CERTAIN COOPERATIVES.**

(a) \* \* \*

(b) AMOUNT OF TAX.—

(1) \* \* \*

(2) LIMITATION.—The amount realized taken into account under paragraph (1) shall not exceed that portion allocable to qualified securities acquired in the sale to which section 1042 applied determined as if such securities were disposed of—

[(A) first, from section 133 securities (as defined in section 4978B(e)(2)) acquired during the 3-year period ending on the date of such disposition, beginning with the securities first so acquired.

[(B) second, from section 133 securities (as so defined) acquired before such 3-year period unless such securities (or proceeds from the disposition) have been allocated to accounts of participants or beneficiaries.”

[(C) third, from qualified securities to which section 1042 applied acquired during the 3-year period ending on

the date of the disposition, beginning with the securities first so acquired, and

[(D) then from any other employer securities.

[[If subsection (d) or section 4978B(d) applies to a disposition, the disposition shall be treated as made from employer securities in the opposite order of the preceding sentence.]]

*(A) first from qualified securities to which section 1042 applied acquired during the 3-year period ending on the date of the disposition, beginning with the securities first so acquired, and*

*(B) then from any other employer securities.*

*If subsection (d) applies to a disposition, the disposition shall be treated as made from employer securities in the opposite order of the preceding sentence.*

\* \* \* \* \*

**[SEC. 4978B. TAX ON DISPOSITION OF EMPLOYER SECURITIES TO WHICH SECTION 133 APPLIED.**

[(a) IMPOSITION OF TAX.—In the case of an employee stockownership plan which has acquired section 133 securities, there is hereby imposed a tax on each taxable event in an amount equal to the amount determined under subsection (b).

[(b) AMOUNT OF TAX.—

[(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be equal to 10 percent of the amount realized on the disposition to the extent allocable to section 133 securities under section 4978(b)(2).

[(2) DISPOSITIONS OTHER THAN SALES OR EXCHANGES.—For purposes of paragraph (1), in the case of a disposition of employer securities which is not a sale or exchange, the amount realized on such disposition shall be the fair market value of such securities at the time of disposition.

[(c) TAXABLE EVENT.—For purposes of this section, the term “taxable event” means any of the following dispositions:

[(1) DISPOSITIONS WITHIN 3 YEARS.—Any disposition of any employer securities by an employee stock ownership plan within 3 years after such plan acquired section 133 securities if—

[(A) the total number of employer securities held by such plan after such disposition is less than the total number of employer securities held after such acquisition, or

[(B) except to the extent provided in regulations, the value of employer securities held by such plan after the disposition is 50 percent or less of the total value of all employer securities as of the time of the disposition.

For purposes of subparagraph (B), the aggregation rule of section 133(b)(6)(D) shall apply.

[(2) STOCK DISPOSED OF BEFORE ALLOCATION.—Any disposition of section 133 securities to which paragraph (1) does not apply if—

[(A) such disposition occurs before such securities are allocated to accounts of participants or their beneficiaries, and

[(B) the proceeds from such disposition are not so allocated.

[(d) SECTION NOT TO APPLY TO CERTAIN DISPOSITIONS.—

[(1) IN GENERAL.—This section shall not apply to any disposition described in paragraph (1), (3), or (4) of section 4978(d).

[(2) CERTAIN REORGANIZATIONS.—For purposes of this section, any exchange of section 133 securities for employer securities of another corporation in any reorganization described in section 368(a)(1) shall not be treated as a disposition, but the employer securities received shall be treated as section 133 securities and as having been held by the plan during the period the securities which were exchanged were held.

[(3) FORCED DISPOSITION OCCURRING BY OPERATION OF STATE LAW.—Any forced disposition of section 133 securities by an employee stock ownership plan occurring by operation of a State law shall not be treated as a disposition. This paragraph shall only apply to securities which, at the time the securities were acquired by the plan, were regularly traded on an established securities market.

[(4) COORDINATION WITH OTHER TAXES.—This section shall not apply to any disposition which is subject to tax under section 4978 or section 4978A (as in effect on the day before the date of enactment of this section).

[(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

[(1) LIABILITY FOR PAYMENT OF TAXES.—The tax imposed by this section shall be paid by the employer.

[(2) SECTION 133 SECURITIES.—The term “section 133 securities” means employer securities acquired by an employee stock ownership plan in a transaction to which section 133 applied.

[(3) DISPOSITION.—The term “disposition” includes any distribution.

[(4) ORDERING RULES.—For ordering rules for dispositions of employer securities, see section 4978(b)(2).]

\* \* \* \* \*

**SEC. 4980A. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.**

(a) \* \* \*

\* \* \* \* \*

(c) EXCESS DISTRIBUTIONS.—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

[(4) SPECIAL RULE WHERE TAXPAYER ELECTS INCOME AVERAGING.—]

(4) *SPECIAL ONE-TIME ELECTION.*—If the retirement distributions with respect to any individual during any calendar year include a lump sum distribution [to which an election under section 402(d)(4)(B) applies] (as defined in section 402(e)(4)(D)) with respect to which the individual elects to have this paragraph apply—

(A) paragraph (1) shall be applied separately with respect to such lump sum distribution and other retirement distributions, and

(B) the limitation under paragraph (1) with respect to such lump sum distribution shall be equal to 5 times the amount of such limitation determined without regard to this subparagraph.

*An individual may elect to have this paragraph apply to only one lump-sum distribution.*

\* \* \* \* \*

(g) *LIMITATION ON APPLICATION.*—This section shall not apply to distributions during years beginning after December 31, 1995, and before January 1, 1999, and such distributions shall be treated as made first from amounts not described in subsection (f).

**SEC. 4980B. FAILURE TO SATISFY CONTINUATION COVERAGE REQUIREMENTS OF GROUP HEALTH PLANS.**

(a) \* \* \*

\* \* \* \* \*

(f) **CONTINUATION COVERAGE REQUIREMENTS OF GROUP HEALTH PLANS.**—

(1) \* \* \*

(2) **CONTINUATION COVERAGE.**—For purposes of paragraph (1), the term “continuation coverage” means coverage under the plan which meets the following requirements:

(A) \* \* \*

(B) **PERIOD OF COVERAGE.**—The coverage must extend for at least the period beginning on the date of the qualifying event and ending not earlier than the earliest of the following:

(i) **MAXIMUM REQUIRED PERIOD.**—

(I) \* \* \*

\* \* \* \* \*

**[(V) QUALIFYING EVENT INVOLVING MEDICARE ENTITLEMENT.**—In the case of an event described in paragraph (3)(D) (without regard to whether such event is a qualifying event), the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event shall not terminate before the close of the 36-month period beginning on the date the covered employee becomes entitled to benefits under title XVIII of the Social Security Act.]

(V) **MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.**—In the case of a qualifying event described in paragraph (3)(B) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than the covered employee shall not terminate under this clause before the close of the 36-month period beginning on the date the covered employee became so entitled.

\* \* \* \* \*

## Subtitle E—Alcohol, Tobacco, and Certain Other Excise Taxes

\* \* \* \* \*

### CHAPTER 51—DISTILLED SPIRITS, WINES, AND BEER

\* \* \* \* \*

#### PART I—GALLONAGE TAXES

\* \* \* \* \*

#### Subpart C—Wines

\* \* \* \* \*

#### SEC. 5041. IMPOSITION AND RATE OF TAX.

(a) \* \* \*

\* \* \* \* \*

(c) CREDIT FOR SMALL DOMESTIC PRODUCERS.—

(1) \* \* \*

\* \* \* \* \*

[(6) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary to prevent the credit provided in this subsection from benefiting any person who produces more than 250,000 wine gallons of wine during a calendar year and to assure proper reduction of such credit for persons producing more than 150,000 wine gallons of wine during a calendar year.]

(6) CREDIT FOR TRANSFEREE IN BOND.—If—

(A) wine produced by any person would be eligible for any credit under paragraph (1) if removed by such person during the calendar year,

(B) wine produced by such person is removed during such calendar year by any other person (hereafter in this paragraph referred to as the “transferee”) to whom such wine was transferred in bond and who is liable for the tax imposed by this section with respect to such wine, and

(C) such producer holds title to such wine at the time of its removal and provides to the transferee such information as is necessary to properly determine the transferee’s credit under this paragraph,

then, the transferee (and not the producer) shall be allowed the credit under paragraph (1) which would be allowed to the producer if the wine removed by the transferee had been removed by the producer on that date.

(7) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations—

(A) to prevent the credit provided in this subsection from benefiting any person who produces more than 250,000 wine gallons during a calendar year, and

*(B) to assure proper reduction of such credit for persons producing more than 150,000 wine gallons of wine during a calendar year.*

\* \* \* \* \*

### **Subpart E—General Provisions**

\* \* \* \* \*

#### **SEC. 5061. METHOD OF COLLECTING TAX.**

(a) \* \* \*

(b) EXCEPTIONS.—Notwithstanding the provisions of subsection (a), any taxes imposed on, or amounts to be paid or collected in respect of, distilled spirits, wines, and beer under—

(1) \* \* \*

\* \* \* \* \*

[(3) section 5041(e),]

(3) section 5041(f),

\* \* \* \* \*

### **PART II—OCCUPATIONAL TAX**

\* \* \* \* \*

### **Subpart F—Nonbeverage Domestic Drawback Claimants**

\* \* \* \* \*

#### **SEC. 5134. DRAWBACK.**

(a) \* \* \*

\* \* \* \* \*

(c) ALLOWANCE OF DRAWBACK EVEN WHERE CERTAIN REQUIREMENTS NOT MET.—

(1) \* \* \*

\* \* \* \* \*

(3) PENALTY TREATED AS TAX.—The penalty imposed by paragraph (2) shall be assessed, collected, and paid in the same manner as taxes, as provided in section [6662(a)] 6665(a).

\* \* \* \* \*

### **Subchapter C—Operation of Distilled Spirits Plants**

\* \* \* \* \*

### **PART I—GENERAL PROVISIONS**

\* \* \* \* \*

#### **SEC. 5206. CONTAINERS.**

(a) \* \* \*

\* \* \* \* \*



## (f) CROSS REFERENCES.—

(1) \* \* \*

(2) For provisions relating to labeling containers of distilled spirits of one gallon or less for nonindustrial uses, see section [5(e)] 105(e) of the Federal Alcohol Administration Act (27 U.S.C. 205(e)).

\* \* \* \* \*

## Subchapter F—Bonded and Taxpaid Wine Premises

\* \* \* \* \*

## SEC. 5354. BOND.

The bond for a bonded wine cellar shall be in such form, on such conditions, and with such adequate surety, as regulations issued by the Secretary shall prescribe, and shall be in a penal sum not less than the tax on any wine or distilled spirits possessed or in transit at any one time (*taking into account the appropriate amount of credit with respect to such wine under section 5041(c)*), but not less than \$1,000 nor more than \$50,000; except that where the tax on such wine and on such distilled spirits exceeds \$250,000, the penal sum of the bond shall be not more than \$100,000. Where additional liability arises as a result of deferral of payment of tax payable on any return, the Secretary may require the proprietor to file a supplemental bond in such amount as may be necessary to protect the revenue. The liability of any person on any such bond shall apply whether the transaction or operation on which the liability of the proprietor is based occurred on or off the proprietor's premises.

\* \* \* \* \*

## Subtitle F—Procedure and Administration

\* \* \* \* \*

### CHAPTER 61—INFORMATION AND RETURNS

\* \* \* \* \*

#### Subchapter A—Returns and records

\* \* \* \* \*

#### PART III—INFORMATION RETURNS

\* \* \* \* \*

#### Subpart A—Information Concerning Persons Subject to Special Provisions

\* \* \* \* \*

**SEC. 6033. RETURNS BY EXEMPT ORGANIZATIONS.**

(a) \* \* \*

\* \* \* \* \*

(e) SPECIAL RULES RELATING TO LOBBYING ACTIVITIES.—

(1) REPORTING REQUIREMENTS.—

(A) \* \* \*

(B) ORGANIZATIONS TO WHICH SUBSECTION APPLIES.—

(i) IN GENERAL.—This subsection shall apply to any organization which is exempt from taxation under **[this subtitle]** section 501 other than an organization described in section 501(c)(3).

\* \* \* \* \*

(iii) COORDINATION WITH SECTION 527(f).—This subsection shall not apply to any amount on which tax is imposed by reason of section 527(f).

\* \* \* \* \*

**SEC. 6037. RETURN OF S CORPORATION.**

(a) \* \* \*

\* \* \* \* \*

(c) SHAREHOLDER'S RETURN MUST BE CONSISTENT WITH CORPORATE RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—

(1) IN GENERAL.—A shareholder of an S corporation shall, on such shareholder's return, treat a subchapter S item in a manner which is consistent with the treatment of such item on the corporate return.

(2) NOTIFICATION OF INCONSISTENT TREATMENT.—

(A) IN GENERAL.—In the case of any subchapter S item, if—

(i) the corporation has filed a return but the shareholder's treatment on his return is (or may be) inconsistent with the treatment of the item on the corporate return, or

(ii) the corporation has not filed a return, and

(ii) the shareholder files with the Secretary a statement identifying the inconsistency,

paragraph (1) shall not apply to such item.

(B) SHAREHOLDER RECEIVING INCORRECT INFORMATION.—

A shareholder shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a subchapter S item if the shareholder—

(i) demonstrates to the satisfaction of the Secretary that the treatment of the subchapter S item on the shareholder's return is consistent with the treatment of the item on the schedule furnished to the shareholder by the corporation, and

(ii) elects to have this paragraph apply with respect to that item.

(3) EFFECT OF FAILURE TO NOTIFY.—In any case—

(A) described in subparagraph (A)(i)(I) of paragraph (2), and

(B) in which the shareholder does not comply with subparagraph (A)(ii) of paragraph (2),

any adjustment required to make the treatment of the items by such shareholder consistent with the treatment of the items on the corporate return shall be treated as arising out of mathematical or clerical errors and assessed according to section 6213(b)(1). Paragraph (2) of section 6213(b) shall not apply to any assessment referred to in the preceding sentence.

(4) *SUBCHAPTER S ITEM.*—For purposes of this subsection, the term “subchapter S item” means any item of an S corporation to the extent that regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the corporation level than at the shareholder level.

(5) *ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.*—

For addition to tax in the case of a shareholder’s negligence in connection with, or disregard of, the requirements of this section, see part II of subchapter A of chapter 68.

#### SEC. 6038. INFORMATION WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS.

(a) *REQUIREMENT.*—

(1) *IN GENERAL.*—Every United States person shall furnish, with respect to any foreign corporation which such person controls (within the meaning of subsection (e)(1)), such information as the Secretary may prescribe by regulations relating to—

(A) \* \* \*

\* \* \* \* \*

(E) a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each United States person who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation[, and].

[(F) such information as the Secretary may require for purposes of carrying out the provisions of section 453C.]

\* \* \* \* \*

[(e)] (f) *CROSS REFERENCES.*—

(1) For provisions relating to penalties for violations of this section, see section 7203.

(2) For definition of the term “United States person”, see section 7701(a)(30).

\* \* \* \* \*

#### SEC. 6038A. INFORMATION WITH RESPECT TO CERTAIN FOREIGN-OWNED CORPORATIONS.

(a) \* \* \*

(b) *REQUIRED INFORMATION.*—For purposes of subsection (a), the information described in this subsection is such information as the Secretary may prescribe by regulations relating to—

(1) \* \* \*

\* \* \* \* \*

(2) the manner in which the reporting corporation is related to each person referred to in paragraph (1), *and*

(3) transactions between the reporting corporation and each foreign person which is a related party to the reporting corporation[, and].

[(4) such information as the Secretary may require for purposes of carrying out the provisions of section 453C.]

\* \* \* \* \*

(e) ENFORCEMENT OF REQUESTS FOR CERTAIN RECORDS.—

(1) \* \* \*

\* \* \* \* \*

(4) JUDICIAL PROCEEDINGS.—

(A) \* \* \*

\* \* \* \* \*

(D) SUSPENSION OF STATUTE OF LIMITATIONS.—If the reporting corporation brings an action under subparagraph (A) or (B), the running of any period of limitations under section 6501 (relating to assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to [any transaction to which the summons relates] *any affected taxable year* shall be suspended for the period during which such proceeding, and appeals therein are pending. In no event shall any such period expire before the 90th day after the day on which there is a final determination in such proceeding. *For purposes of this subparagraph, the term “affected taxable year” means any taxable year if the determination of the amount of tax imposed for such taxable year is affected by the treatment of the transaction to which the summons relates.*

\* \* \* \* \*

**Subpart B—Information Concerning Transactions With Other Persons**

Sec. 6041. Information at source.

\* \* \* \* \*

Sec. 6043. Liquidating[;], etc., transactions.

\* \* \* \* \*

Sec. 6050Q. Returns relating to certain purchases of fish.

\* \* \* \* \*

**SEC. 6043. LIQUIDATING[;], ETC., TRANSACTIONS.**

(a) \* \* \*

\* \* \* \* \*

**SEC. 6045. RETURNS OF BROKERS.**

(a) \* \* \*

**(e) RETURN REQUIRED IN THE CASE OF REAL ESTATE TRANSACTIONS.—**

(1) \* \* \*

\* \* \* \* \*

(3) PROHIBITION OF SEPARATE CHARGE FOR FILING RETURN.—  
It shall be unlawful for any real estate reporting person to separately charge any customer for complying with any requirement of paragraph (1). *Nothing in this paragraph shall be construed to prohibit the real estate reporting person from taking into account its cost of complying with such requirement in establishing its charge (other than a separate charge for complying with such requirement) to any customer for performing services in the case of a real estate transaction.*

\* \* \* \* \*

**SEC. 6047. INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY PLANS.**

(a) \* \* \*

\* \* \* \* \*

(d) REPORTS BY EMPLOYERS, PLAN ADMINISTRATORS, ETC.—

(1) IN GENERAL.—The Secretary shall by forms or regulations require that—

(A) the employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, a plan from which designated distributions (as defined in section 3405(e)(1)) may be made, and

(B) any person issuing any contract under which designated distributions (as so defined) may be made, make returns and reports regarding such plan (or contract) to the Secretary, to the participants and beneficiaries of such plan (or contract), and to such other persons as the Secretary may by regulations prescribe. *No return or report may be required under the preceding sentence with respect to distributions to any person during any year unless such distributions aggregate \$10 or more.*

\* \* \* \* \*

(e) EMPLOYEE STOCK OWNERSHIP PLANS.—The Secretary shall require—

[(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan—

[(A) which acquired stock in a transaction to which section 133 applies, or

[(B) which holds stock with respect to which section 404(k) applies to dividends paid on such stock,

[(2) any person making or holding a loan to which section 133 applies, or

[(3) both such employer or plan administrator and such person,]

*(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan which holds stock with respect to which section 404(k) applies to dividends paid on such stock, or*

*(2) both such employer or plan administrator, to make returns and reports regarding such plan, transaction, or loan to the Secretary and to such other persons as the Secretary may prescribe. Such returns and reports shall be made in such*

form, shall be made at such time, and shall contain such information as the Secretary may prescribe.

(f) CROSS REFERENCES.—

**[(1) For provisions relating to penalties for failure to file a return required by this section, see section 6652(e).]**

**(1) For provisions relating to penalties for failures to file returns and reports required under this section, see sections 6652(e), 6721, and 6722.**

**(2) For criminal penalty for furnishing fraudulent information, see section 7207.**

**(3) For provisions relating to penalty for failure to comply with the provisions of subsection (d), see section 6704.**

\* \* \* \* \*

#### **SEC. 6050A. REPORTING REQUIREMENTS OF CERTAIN FISHING BOAT OPERATORS.**

(a) **REPORTS.**—The operator of a boat on which one or more individuals, during a calendar year, perform services described in section 3121(b)(20) shall submit to the Secretary (at such time, and in such manner and form, as the Secretary shall by regulations prescribe) information respecting—

(1) \* \* \*

\* \* \* \* \*

(3) if such individual receives his share in kind, the type and weight of such share, together with such other information as the Secretary may prescribe by regulations reasonably necessary to determine the value of such share; **[and]**

(4) if such individual receives a share of the proceeds of such catches, the amount so received**[.]**; *and*

(5) *any cash remuneration described in section 3121(b)(20)(A).*

\* \* \* \* \*

#### **SEC. 6050B. RETURNS RELATING TO UNEMPLOYMENT COMPENSATION.**

(a) \* \* \*

\* \* \* \* \*

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

(1) **UNEMPLOYMENT COMPENSATION.**—The term “unemployment compensation” has the meaning given to such term by section **[85(c)] 85(b)**.

(2) **PERSON.**—The term “person” means the officer or employee having control of the payment of the unemployment compensation, or the person appropriately designated for purposes of this section.

\* \* \* \* \*

#### **SEC. 6050Q. RETURNS RELATING TO CERTAIN PURCHASES OF FISH.**

(a) **REQUIREMENT OF REPORTING.**—*Every person—*

*(1) who is engaged in the trade or business of purchasing fish for resale from any person engaged in the trade or business of catching fish; and*

*(2) who makes payments in cash in the course of such trade or business to such a person of \$600 or more during any calendar year for the purchase of fish,*

shall make a return (at such times as the Secretary may prescribe) described in subsection (b) with respect to each person to whom such a payment was made during such calendar year.

(b) *RETURN*.—A return is described in this subsection if such return—

(1) is in such form as the Secretary may prescribe, and

(2) contains—

(A) the name, address, and TIN of each person to whom a payment described in subsection (a)(2) was made during the calendar year;

(B) the aggregate amount of such payments made to such person during such calendar year and the date and amount of each such payment, and

(C) such other information as the Secretary may require.

(c) *STATEMENT TO BE FURNISHED WITH RESPECT TO WHOM INFORMATION IS REQUIRED*.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

(1) the name and address of the person required to make such a return, and

(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) is required to be made.

(d) *DEFINITIONS*.—For purposes of this section:

(1) *CASH*.—The term “cash” has the meaning given such term by section 6050I(d).

(2) *FISH*.—The term “fish” includes other forms of aquatic life.

\* \* \* \* \*

## Subchapter B—Miscellaneous Provisions

\* \* \* \* \*

### SEC. 6103. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) \* \* \*

\* \* \* \* \*

(e) *DISCLOSURE TO PERSONS HAVING MATERIAL INTEREST*.—

(1) *IN GENERAL*.—The return of a person shall, upon written request, be open to inspection by or disclosure to—

(A) in the case of the return of an individual—

(i) \* \* \*

\* \* \* \* \*

(iv) the child of that individual (or such child’s legal representative) to the extent necessary to comply with the provisions of [section 1(i) or 59(j);] *section 1(g) or 59(j)*;

\* \* \* \* \*

**SEC. 6109. IDENTIFYING NUMBERS.**

(a) \* \* \*

\* \* \* \* \*

**[(f)] (g) ACCESS TO EMPLOYER IDENTIFICATION NUMBERS BY FEDERAL CROP INSURANCE CORPORATION FOR PURPOSES OF THE FEDERAL CROP INSURANCE ACT.—**

(1) \* \* \*

\* \* \* \* \*

## **CHAPTER 62—TIME AND PLACE FOR PAYING TAX**

\* \* \* \* \*

### **Subchapter B—Extensions of Time for Payment**

\* \* \* \* \*

**SEC. 6166. EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX WHERE ESTATE CONSISTS LARGELY OF INTEREST IN CLOSELY HELD BUSINESS.**

(a) \* \* \*

\* \* \* \* \*

(k) CROSS REFERENCES.—

(1) \* \* \*

\* \* \* \* \*

**[(6) Payment of estate tax by employee stock ownership plan or eligible worker-owned cooperative.—For provision allowing plan administrator or eligible worker-owned cooperative to elect to pay a certain portion of the estate tax in installments under the provisions of this section, see section 2210(c).]**

\* \* \* \* \*

## **CHAPTER 63—ASSESSMENT**

SUBCHAPTER A. In general.

\* \* \* \* \*

**[SUBCHAPTER D. Tax Treatment of subchapter S items.]**

\* \* \* \* \*

### **Subchapter B—Deficiency Procedures in the Case of Income, Estate, Gift, and Certain Excise Taxes**

\* \* \* \* \*

**SEC. 6214. DETERMINATIONS BY TAX COURT.**

(a) \* \* \*

\* \* \* \* \*

**[(e) CROSS REFERENCES.—**

**[(1) For provision giving Tax Court jurisdiction to determine whether any portion of deficiency is a substantial underpayment attributable to tax motivated transactions, see section 6621(c)(4).**

**[(2) For provision giving Tax Court jurisdiction to order a refund of an overpayment and to award sanctions, see section 6512(b)(2).]**



(e) *CROSS REFERENCE.*—

*For provision giving Tax Court jurisdiction to order a refund of an overpayment and to award sanctions, see section 6512(b)(2).*

\* \* \* \* \*

## Subchapter C—Tax Treatment of Partnership Items

\* \* \* \* \*

### SEC. 6233. EXTENSION TO ENTITIES FILING PARTNERSHIP RETURNS, ETC.

(a) \* \* \*

[(b) SIMILAR RULES IN CERTAIN CASES.—If for any taxable year—

[(1) an entity files a return as an S corporation but it is determined that the entity was not an S corporation for such year, or

[(2) a partnership return or S corporation return is filed but it is determined that there is no entity for such taxable year, then, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.]

(b) *SIMILAR RULES IN CERTAIN CASES.*—*If a partnership return is filed for any taxable year but it is determined that there is no entity for such taxable year, to the extent provided in regulations, rules similar to the rules of subsection (a) shall apply.*

\* \* \* \* \*

## [Subchapter D—Tax Treatment of Subchapter S Items

[Sec. 6241. Tax treatment determined at corporate level.

[Sec. 6242. Shareholder's return must be consistent with corporate return or Secretary notified of inconsistency.

[Sec. 6243. All shareholders to be notified of proceedings and given opportunity to participate.

[Sec. 6244. Certain partnership provisions made applicable.

[Sec. 6245. Subchapter S item defined.

### [SEC. 6241. TAX TREATMENT DETERMINED AT CORPORATE LEVEL.

[Except as otherwise provided in regulations prescribed by the Secretary, the tax treatment of any subchapter S item shall be determined at the corporate level.

### [SEC. 6242. SHAREHOLDER'S RETURN MUST BE CONSISTENT WITH CORPORATE RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.

[A shareholder of an S corporation shall, on such shareholder's return, treat a subchapter S item in a manner which is consistent with the treatment of such item on the corporate return unless the shareholder notifies the Secretary (at the time and in the manner prescribed by regulations) of the inconsistency.

**[SEC. 6243. ALL SHAREHOLDERS TO BE NOTIFIED OF PROCEEDINGS AND GIVEN OPPORTUNITY TO PARTICIPATE.**

【In the manner and at the time prescribed in regulations, each shareholder in a corporation shall be given notice of, and the right to participate in, any administrative or judicial proceeding for the determination at the corporate level of any subchapter S item.

**[SEC. 6244. CERTAIN PARTNERSHIP PROVISIONS MADE APPLICABLE.**

【The provisions of—

【(1) subchapter C which relate to—

【(A) assessing deficiencies, and filing claims for credit or refund, with respect to partnership items, and

【(B) judicial determination of partnership items, and

【(2) so much of the other provisions of this subtitle as relate to partnership items,  
are (except to the extent modified or made inapplicable in regulations) hereby extended to and made applicable to subchapter S items.

**[SEC. 6245. SUBCHAPTER S ITEM DEFINED.**

【For purposes of this subchapter, the term “subchapter S item” means any item of an S corporation to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the corporate level than at the shareholder level.】

\* \* \* \* \*

## **CHAPTER 64—COLLECTION**

\* \* \* \* \*

### **Subchapter A—General Provisions**

\* \* \* \* \*

**SEC. 6302. MODE OR TIME OF COLLECTION.**

(a) \* \* \*

\* \* \* \* \*

(g) **DEPOSITS OF SOCIAL SECURITY TAXES AND WITHHELD INCOME TAXES.**—If, under regulations prescribed by the Secretary, a person is required to make deposits of taxes imposed by chapters 21, 22, and 24 on the basis of eight-month periods, such person shall make deposits of such taxes on the 1st banking day after any day on which such person has \$100,000 or more of such taxes for deposit.

\* \* \* \* \*

## **CHAPTER 65—ABATEMENTS, CREDITS, AND REFUNDS**

\* \* \* \* \*

### **Subchapter B—Rules of Special Application**

\* \* \* \* \*

**SEC. 6416. CERTAIN TAXES ON SALES AND SERVICES.**

(a) \* \* \*

(b) **SPECIAL CASES IN WHICH TAX PAYMENTS CONSIDERED OVERPAYMENTS.**—Under regulations prescribed by the Secretary, credit or refund (without interest) shall be allowed or made in respect of the overpayments determined under the following paragraphs:

(1) **PRICE READJUSTMENTS.**—

(A) **IN GENERAL.**—Except as provided in subparagraph (B) or (C), if the price of any article in respect of which a tax, based on such price, is imposed by **chapter 32** or by **section 4051** *chapter 31 or 32*, is readjusted by reason of the return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance, including a readjustment for local advertising (but only to the extent provided in **section 4216(e)(2) and (3)**), the part of the tax proportionate to the part of the price repaid or credited to the purchaser shall be deemed to be an overpayment.

\* \* \* \* \*

**SEC. 6427. FUELS NOT USED FOR TAXABLE PURPOSES.**

(a) \* \* \*

\* \* \* \* \*

**[(g) ADVANCE REPAYMENT OF INCREASED DIESEL FUEL TAX TO ORIGINAL PURCHASERS OF DIESEL.**—Upowered Automobiles and Light Trucks.—

**[(1) IN GENERAL.**—Except as provided in subsection (k), the Secretary shall pay (without interest) to the original purchaser of any qualified diesel-powered highway vehicle an amount equal to the diesel fuel differential amount.

**[(2) QUALIFIED DIESEL-POWERED HIGHWAY VEHICLE.**—For purposes of this subsection, the term “qualified diesel-powered highway vehicle” means any diesel-powered highway vehicle which—

**[(A)** has at least 4 wheels,

**[(B)** has a gross vehicle weight rating of 10,000 pounds or less, and

**[(C)** is registered for highway use in the United States under the laws of any State.

**[(3) DIESEL FUEL DIFFERENTIAL AMOUNT.**—For purposes of this subsection, the term “diesel fuel differential amount” means—

**[(A)** except as provided in subparagraph (B), \$102, or

**[(B)** in the case of a truck or van, \$198.

**[(4) Original purchaser.**—For purposes of this subsection—

**[(A) IN GENERAL.**— Except as provided in subparagraph (B), the term “original purchaser” means the first person to purchase the qualified diesel-powered vehicle for use other than resale.

**[(B) EXCEPTION FOR CERTAIN PERSONS NOT SUBJECT TO FUELS TAX.**—The term “original purchaser” shall not include any State or local government (as defined in **section 4221(d)(4)**) or any nonprofit educational organization (as defined in **section 4221(d)(5)**).

**[(C) TREATMENT OF DEMONSTRATION USE BY DEALER.—**

For purposes of subparagraph (A), use as a demonstrator by a dealer shall not be taken into account.

**[(5) VEHICLES TO WHICH SUBSECTION APPLIES.—**Except as provided in paragraph (6), this subsection shall only apply to qualified diesel-powered highway vehicles originally purchased after January 1, 1985, and before January 1, 1999.

**[(6) SPECIAL RULE FOR CERTAIN VEHICLES HELD ON JANUARY 1, 1985.—**

**[(A) IN GENERAL.—**In the case of any person holding a qualified diesel-powered highway vehicle on January 1, 1985—

**[(i)]** such person shall be treated as if he originally purchased such vehicle on December 31, 1984, but

**[(ii)]** the amount payable under paragraph (1) to such person for such vehicle shall be the applicable fraction of the diesel fuel differential amount.

**[(B) APPLICABLE FRACTION.—**For purposes of subparagraph (A), the applicable fraction is the fraction determined in accordance with the following table:

<b>If the model year of the vehicle is:</b>	<b>The applicable fraction is:</b>
1984 or 1985 .....	1
1983 .....	$\frac{5}{6}$
1982 .....	$\frac{4}{6}$
1981 .....	$\frac{3}{6}$
1980 .....	$\frac{2}{6}$
1979 .....	$\frac{1}{6}$

In the case of a 1978 or earlier model year vehicle, the applicable fraction shall be zero.

**[(7) BASIS REDUCTION.—**For the purposes of subtitle A, the basis of any qualified diesel-powered highway vehicle shall be reduced by the amount payable under this subsection with respect to such vehicle.]

\* \* \* \* \*

(i) **TIME FOR FILING CLAIMS; PERIOD COVERED.—**

(1) **GENERAL RULE.—**Except as otherwise provided in this subsection, not more than one claim may be filed under subsection (a), (b), (c), (d), [(g),] (h), (l) or (q) by any person with respect to fuel used [(or a qualified diesel powered highway vehicle purchased)] during his taxable year; and no claim shall be allowed under this paragraph with respect to fuel used [(or a qualified diesel powered highway vehicle purchased)] during any taxable year unless filed by the purchaser not later than the time prescribed by law for filing a claim for credit or refund of overpayment of income tax for such taxable year. For purposes of this paragraph, a person's taxable year shall be his taxable year for purposes of subtitle A.

(2) **EXCEPTIONS.—**

**(A) IN GENERAL.—**If \$1,000 or more is payable under subsections (a), (b), (d), [(g),] (h), and (q) to any person with respect to fuel used [(or a qualified diesel powered highway vehicle purchased)] during any of the first 3 quarters of his taxable year, a claim may be filed under

this section by the purchaser with respect to fuel used [(or a qualified diesel powered highway vehicle purchased)], during such quarter.

\* \* \* \* \*

## CHAPTER 66—LIMITATIONS

\* \* \* \* \*

### Subchapter A—Procedure in General

\* \* \* \* \*

#### SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) \* \* \*

\* \* \* \* \*

[(m) DEFICIENCY ATTRIBUTABLE TO ELECTION UNDER SECTION 44B.—The period for assessing a deficiency attributable to any election under section 44B (or any revocation thereof) shall not expire before the date 1 year after the date on which the Secretary is notified of such election (or revocation).]

[(n)] (m) DEFICIENCIES ATTRIBUTABLE TO ELECTION OF CERTAIN CREDITS.—The period for assessing a deficiency attributable to any election under [section 40(f) or 51(j)] *section 30(d)(4), 40(f), 43, 45B, or 51(j)* (or any revocation thereof) shall not expire before the date 1 year after the date on which the Secretary is notified of such election (or revocation).

[(o)] (n) CROSS REFERENCES.—

(1) For period of limitations for assessment and collection in the case of a joint income return filed after separate returns have been filed, see section 6013(b)(3) and (4).

(2) For extension of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229.

\* \* \* \* \*

#### SEC. 6503. SUSPENSION OF RUNNING OF PERIOD OF LIMITATION.

(a) \* \* \*

\* \* \* \* \*

[(k)] (j) EXTENSION IN CASE OF CERTAIN SUMMONSES.—

(1) IN GENERAL.—If any designated summons is issued by the Secretary with respect to any return of tax by a corporation, the running of any period of limitations provided in section 6501 on the assessment of such tax shall be suspended—

(A) \* \* \*

\* \* \* \* \*

[(l)] (k) CROSS REFERENCES.—

For suspension in case of—

\* \* \* \* \*

## CHAPTER 67—INTEREST

\* \* \* \* \*

## Subchapter C—Determination of Interest Rate; Compounding of Interest

\* \* \* \* \*

### SEC. 6621. DETERMINATION OF RATE OF INTEREST.

(a) \* \* \*

\* \* \* \* \*

### (c) INCREASE IN UNDERPAYMENT RATE FOR LARGE CORPORATE UNDERPAYMENTS.—

(1) \* \* \*

(2) APPLICABLE RATE.—For purposes of this subsection—

(A) IN GENERAL.—The applicable date is the 30th day after the earlier of—

(i) the date on which the 1st letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent, or

(ii) the date on which the deficiency notice under section 6212 is sent.

*The preceding sentence shall be applied without regard to any such letter or notice which is withdrawn by the Secretary.*

(B) SPECIAL RULES.—

(i) NONDEFICIENCY PROCEDURES.—In the case of any underpayment of any tax imposed by this [subtitle] *title* to which the deficiency procedures do not apply, subparagraph (A) shall be applied by taking into account any letter or notice provided by the Secretary which notifies the taxpayer of the assessment or proposed assessment of the tax.

\* \* \* \* \*

## CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

\* \* \* \* \*

### Subchapter A—Additions to the Tax and Additional Amounts

\* \* \* \* \*

#### PART I—GENERAL PROVISIONS

Sec. 6651. Failure to file tax return or to pay tax.

\* \* \* \* \*

[Sec. 6662. Applicable rules.]

\* \* \* \* \*

**SEC. 6652. FAILURE TO FILE CERTAIN INFORMATION RETURNS, REGISTRATION STATEMENTS, ETC.**

(a) \* \* \*

(e) INFORMATION REQUIRED IN CONNECTION WITH CERTAIN PLANS OF DEFERRED COMPENSATION, ETC.—In the case of failure to file a return or statement required under section 6058 (relating to information required in connection with certain plans of deferred compensation), 6047 (relating to information relating to certain trusts and annuity and bond purchase plans), or 6039D (relating to returns and records with respect to certain fringe benefit plans) on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause, there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing so to file, \$25 for each day during which such failure continues, but the total amount imposed under this subsection on any person for failure to file any return shall not exceed \$15,000. *This subsection shall not apply to any return or statement which is an information return described in section 6724(d)(1)(C)(ii) or a payee statement described in section 6724(d)(2)(W).*

\* \* \* \* \*

(i) FAILURE TO GIVE WRITTEN EXPLANATION TO RECIPIENTS OF CERTAIN QUALIFYING ROLLOVER DISTRIBUTIONS.—In the case of each failure to provide a written explanation as required by section 402(f), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such written explanation, an amount equal to ~~the \$10~~ \$100 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed ~~[\$5,000]~~ \$50,000.

\* \* \* \* \*

**SEC. 6655. FAILURE BY CORPORATION TO PAY ESTIMATED INCOME TAX.**

(a) \* \* \*

\* \* \* \* \*

(g) DEFINITIONS AND SPECIAL RULES.—

(1) \* \* \*

\* \* \* \* \*

(3) CERTAIN TAX-EXEMPT ORGANIZATIONS.—For purposes of this section—

(A) \* \* \*

\* \* \* \* \*

(C) Any reference to taxable income shall be treated as including a reference to unrelated business taxable income or net investment income (as the case may be).

In the case of any organization described in subparagraph (A), subsection (b)(2)(A) shall be applied by substituting “5th month” for “3rd month”~~],~~ and, except in the case of an election under subsection (e)(2)(C), subsection (e)(2)(A) shall be applied by substituting “2 months” for “3 months” and in clause (i)(I),

by substituting “4 months” for “5 months” in clause (i)(II), by substituting “7 months” for “8 months” in clause (i)(III), and by substituting “10 months” for “11 months” in clause (i)(IV).**】**, subsection (e)(2)(A) shall be applied by substituting “2 months” for “3 months” in clause (i)(I), the election under clause (i) of subsection (e)(2)(C) may be made separately for each installment, and clause (ii) of subsection (e)(2)(C) shall not apply.

\* \* \* \* \*

## Subchapter B—Assessable Penalties

\* \* \* \* \*

### PART I—GENERAL PROVISIONS

Sec. 6671. Rules for application of assessable penalties.

\* \* \* \* \*

Sec. **【6714.】** 6715. Dyed fuel sold for use in or used in taxable use, etc.

\* \* \* \* \*

### SEC. 6693. FAILURE TO PROVIDE REPORTS ON INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES; PENALTIES RELATING TO DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.

(a) The person required by subsection (i) or (l) of section 408 to file a report regarding an individual retirement account or individual retirement annuity at the time and in the manner required by such subsection shall pay a penalty of \$50 for each failure unless it is shown that such failure is due to reasonable cause. *This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(V).*

\* \* \* \* \*

#### (c) PENALTIES RELATING TO SIMPLE RETIREMENT ACCOUNTS.—

(1) *EMPLOYER PENALTIES.*—An employer who fails to provide 1 or more notices required by section 408(l)(2)(C) shall pay a penalty of \$50 for each day on which such failures continue.

(2) *TRUSTEE PENALTIES.*—A trustee who fails—

(A) to provide 1 or more statements required by the last sentence of section 408(i) shall pay a penalty of \$50 for each day on which such failures continue, or

(B) to provide 1 or more summary descriptions required by section 408(l)(2)(B) shall pay a penalty of \$50 for each day on which such failures continue.

(3) *REASONABLE CAUSE EXCEPTION.*—No penalty shall be imposed under this subsection with respect to any failure which the taxpayer shows was due to reasonable cause.

**【(c)】** (d) *DEFICIENCY PROCEDURES NOT TO APPLY.*—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) does not apply to the assessment or collection of any penalty imposed by this section.



**SEC. 6714. FAILURE TO MEET DISCLOSURE REQUIREMENTS APPLICABLE TO QUID PRO QUO CONTRIBUTIONS.**

(a) **IMPOSITION OF PENALTY.**—If an organization fails to meet the disclosure requirement of section 6115 with respect to a quid pro quo contribution, such organization shall pay a penalty of \$10 for each contribution in respect of which the organization fails to make the required disclosure, except that the total penalty imposed by this subsection with respect to a particular fundraising event or mailing shall not exceed \$5,000.

(b) **REASONABLE CAUSE EXCEPTION.**—No penalty shall be imposed under this section with respect to any failure if it is shown that such failure is due to reasonable cause.

**SEC. [6714.] 6715. DYED FUEL SOLD FOR USE OR USED IN TAXABLE USE, ETC.**

(a) **IMPOSITION OF PENALTY.**—If—

(1) any dyed fuel is sold or held for sale by any person for any use which such person knows or has reason to know is not a nontaxable use of such fuel,

(2) \* \* \*

\* \* \* \* \*

**PART II—FAILURE TO COMPLY WITH CERTAIN INFORMATION REPORTING REQUIREMENTS**

\* \* \* \* \*

**SEC. 6724. WAIVER; DEFINITIONS AND SPECIAL RULES.**

(a) \* \* \*

\* \* \* \* \*

(d) **DEFINITIONS.**—For purposes of this part—

(1) **INFORMATION RETURN.**—The term “information return” means—

(A) any statement of the amount of payments to another person required by—

(i) \* \* \*

\* \* \* \* \*

(vi) section 6050N(a) (relating to payments of royalties), **[or]**

(vii) section 6051(d) (relating to information returns with respect to income tax withheld), **[and]** *or*

(viii) *section 6050Q (relating to returns relating to certain purchases of fish), and*

(B) any return required by—

(i) \* \* \*

\* \* \* \* \*

(xii) subparagraph (A) or (C) of subsection (c)(4), or section 4093 (relating to information reporting with respect to tax on diesel and aviation fuels), **[or]**

(xiii) section 4101(d) (relating to information reporting with respect to fuels taxes) **[.]**, *or*

(xiv) subparagraph (C) of section 338(h)(10) (relating to information required to be furnished to the Sec-

retary in case of elective recognition of gain or loss) **[.]**,  
and

(C) any statement of the amount of payments to another person required to be made to the Secretary under—

(i) section 408(i) (relating to reports with respect to individual retirement accounts or annuities), or

(ii) section 6047(d) (relating to reports by employers, plan administrators, etc.).

Such term also includes any form, statement, or schedule required to be filed with the Secretary with respect to any amount from which tax was required to be deducted and withheld under chapter 3 (or from which tax would be required to be so deducted and withheld but for an exemption under this title or any treaty obligation of the United States).

(2) PAYEE STATEMENT.—The term “payee statement” means any statement required to be furnished under—

(A) section 6031 (b) or (c), 6034A, or 6037(b) (relating to statements furnished by certain pass-thru entities),

\* \* \* \* \*

(Q) section 6050Q(c) (relating to returns relating to certain purchases of fish),

**[(Q)]** (R) section 6051 (relating to receipts for employees),

**[(R)]** (S) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

**[(S)]** (T) section 6053 (b) or (c) (relating to reports of tips), **[or]**

**[(T)]** (U) section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels) **[.]**,

(V) section 408(i) (relating to reports with respect to individual retirement plans) to any person other than the Secretary with respect to the amount of payments made to such person, or

(W) section 6047(d) (relating to reports by plan administrators) to any person other than the Secretary with respect to the amount of payments made to such person.

Such term also includes any form, statement, or schedule required to be furnished to the recipient of any amount from which tax was required to be deducted and withheld under chapter 3 (or from which tax would be required to be so deducted and withheld but for an exemption under this title or any treaty obligation of the United States).

(3) Specified information reporting requirement.—The term “specified information reporting requirement” means—

(A) \* \* \*

\* \* \* \* \*

(E) any requirement under section **[6109(f)]** 6109(h) that—

(i) a person include on his return the name, address, and TIN of another person, or

(ii) a person furnish his TIN to another person.

\* \* \* \* \*

#### SEC. 7012. CROSS REFERENCES.

(1) \* \* \*

\* \* \* \* \*

(3) For provisions relating to registration in relation to the [production or importation of gasoline] *taxes on gasoline and diesel fuel*, see section 4101.

[(4) For provisions relating to registration in relation to the manufacture or production of lubricating oils, see section 4101.]

[(5)] (4) For penalty for failure to register, see section 7272.

[(6)] (5) For other penalties for failure to register with respect to wagering, see section 7262.

\* \* \* \* \*

## CHAPTER 75—CRIMES, OTHER OFFENSES, AND FIREARMS

\* \* \* \* \*

### Subchapter A—Crimes

\* \* \* \* \*

#### PART II—PENALTIES APPLICABLE TO CERTAIN TAXES

Sec. 7231. Failure to obtain license for collection of foreign items.

Sec. 7232. Failure to register, or false statement by manufacturer or producer of gasoline, [lubricating oil,] diesel fuel, or aviation fuel.

\* \* \* \* \*

#### SEC. 7232. FAILURE TO REGISTER, OR FALSE STATEMENT BY MANUFACTURER OR PRODUCER OF GASOLINE, [LUBRICATING OIL,] DIESEL FUEL, OR AVIATION FUEL.

Every person who fails to register as required by section 4101, or who in connection with any purchase of gasoline, [lubricating oil,] diesel fuel, or aviation fuel falsely represents himself to be registered as provided by section 4101, or who willfully makes any false statement in an application for registration under section 4101, shall, upon conviction thereof, be fined not more than \$5,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution.

\* \* \* \* \*

## CHAPTER 76—JUDICIAL PROCEEDINGS

\* \* \* \* \*

### Subchapter C—The Tax Court

\* \* \* \* \*

## PART II—PROCEDURE

\* \* \* \* \*

### SEC. 7454. BURDEN OF PROOF IN FRAUD, FOUNDATION MANAGER, AND TRANSFEREE CASES.

(a) \* \* \*

(b) FOUNDATION MANAGERS.—In any proceeding involving the issue whether a foundation manager (as defined in section 4946(b)) has “knowingly” participated in an act of self-dealing (within the meaning of section 4941), participated in an investment which jeopardizes the carrying out of exempt purposes (within the meaning of section 4944), or agreed to the making of a taxable expenditure (within the meaning of section 4945), or whether the trustee of a trust described in section 501(c)(21) has “knowingly” participated in an act of self-dealing (within the meaning of section 4951) or agreed to the making of a taxable expenditure (within the meaning of section 4952), or whether an organization manager (as defined in [section 4955(e)(2)] *section 4955(f)(2)*) has “knowingly” agreed to the making of a political expenditure (within the meaning of section 4955), or whether an organization manager (as defined in section 4912(d)(2)) has “knowingly” agreed to the making of disqualifying lobbying expenditures within the meaning of section 4912(b), the burden of proof in respect of such issue shall be upon the Secretary.

\* \* \* \* \*

## CHAPTER 78—DISCOVERY OF LIABILITY AND ENFORCEMENT OF TITLE

\* \* \* \* \*

### Subchapter A—Examination and Inspection

\* \* \* \* \*

### SEC. 7611. RESTRICTIONS ON CHURCH TAX INQUIRIES AND EXAMINATIONS.

(a) \* \* \*

\* \* \* \* \*

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

(1) \* \* \*

\* \* \* \* \*

(7) APPROPRIATE HIGH-LEVEL TREASURY OFFICIAL.—The term “[appropriate] *appropriate* high-level Treasury official” means the Secretary of the Treasury or any delegate of the Secretary whose rank is no lower than that of a principal Internal Revenue officer for an internal revenue region.

\* \* \* \* \*

## CHAPTER 79—DEFINITIONS

\* \* \* \* \*

**SEC. 7701. DEFINITIONS.**

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

(1) \* \* \*

\* \* \* \* \*

(20) **EMPLOYEE.**—For the purpose of applying the provisions of section 79 with respect to group-term life insurance purchased for employees, for the purpose of applying the provisions of sections 104, 105, and 106 with respect to accident and health insurance or accident and health plans], for the purpose of applying the provisions of section 101(b) with respect to employees' death benefits], and for the purpose of applying the provisions of subtitle A with respect to contributions to or under a stock bonus, pension, profit-sharing, or annuity plan, and with respect to distributions under such a plan, or by a trust forming part of such a plan, and for purposes of applying section 125 with respect to cafeteria plans, the term "employee" shall include a full-time life insurance salesman who is considered an employee for the purpose of chapter 21, or in the case of services performed before January 1, 1951, who would be considered an employee if his services were performed during 1951.

\* \* \* \* \*

## **CHAPTER 80—GENERAL RULES**

\* \* \* \* \*

### **Subchapter C—Provisions Affecting More Than One Subtitle**

\* \* \* \* \*

**SEC. 7872. TREATMENT OF LOANS WITH BELOW-MARKET INTEREST RATES.**

(a) **TREATMENT OF GIFT LOANS AND DEMAND LOANS.**—

(1) **IN GENERAL.**—For purposes of this title, in the case of any below-market loan to which this section applies and which is a gift loan or a demand loan, the [foregone] *forgone* interest shall be treated as—

(A) transferred from the lender to the borrower, and

(B) retransferred by the borrower to the lender as interest.

(2) **TIME WHEN TRANSFERS MADE.**—Except as otherwise provided in regulations prescribed by the Secretary, any [foregone] *forgone* interest attributable to periods during any calendar year shall be treated as transferred (and retransferred) under paragraph (1) on the last day of such calendar year.

\* \* \* \* \*

(e) **DEFINITIONS OF BELOW-MARKET LOAN AND [FOREGONE] FORGONE INTEREST.**—For purposes of this section—

(1) \* \* \*

(2) **[FOREGONE] FORGONE INTEREST.**—The term “**[foregone] forgone interest**” means, with respect to any period during which the loan is outstanding, the excess of—

(A) the amount of interest which would have been payable on the loan for the period if interest accrued on the loan at the applicable Federal rate and were payable annually on the day referred to in subsection (a)(2), over

(B) any interest payable on the loan properly allocable to such period.

(f) **OTHER DEFINITIONS AND SPECIAL RULES.**—For purposes of this section—

(1) \* \* \*

\* \* \* \* \*

**[(12) SPECIAL RULE FOR CERTAIN EMPLOYER SECURITY LOANS.**—This section shall not apply to any loan between a corporation (or any member of the controlled group of corporations which includes such corporation) and an employee stock ownership plan described in section 4975(e)(7) to the extent that the interest rate on such loan is equal to the interest rate paid on a related securities acquisition loan (as described in section 133(b)) to such corporation.]

\* \* \* \* \*

## Subtitle I—Trust Fund Code

\* \* \* \* \*

### CHAPTER 98 TRUST FUND CODE

\* \* \* \* \*

#### Subchapter A—Establishment of Trust Funds

\* \* \* \* \*

#### SEC. 9502. AIRPORT AND AIRWAY TRUST FUND.

(a) \* \* \*

(b) **TRANSFER TO AIRPORT AND AIRWAY TRUST FUND OF AMOUNTS EQUIVALENT TO CERTAIN TAXES.**—There is hereby appropriated to the Airport and Airway Trust Fund—

(1) \* \* \*

(2) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the Treasury after August 31, 1982, *and before* January 1, 1996, under section 4081 (to the extent of 14 cents per gallon), with respect to gasoline used in aircraft;

\* \* \* \* \*

## Subtitle J—Coal Industry Health Benefits

\* \* \* \* \*

## CHAPTER 99—COAL INDUSTRY HEALTH BENEFITS

\* \* \* \* \*

### Subchapter B—Combined Benefit Fund

\* \* \* \* \*

## PART III—ENFORCEMENT

\* \* \* \* \*

### SEC. 9707. FAILURE TO PAY PREMIUM.

(a) \* \* \*

\* \* \* \* \*

(d) LIMITATIONS ON A OF PENALTY.—

(1) IN GENERAL.—No penalty shall be imposed by subsection (a) on any failure during any period for which it is established to the satisfaction of the Secretary of the Treasury that none of the persons responsible for such failure knew, or exercising reasonable [diligence,] *diligence* would have known, that such failure existed.

\* \* \* \* \*

---

## REVENUE RECONCILIATION ACT OF 1993

# TITLE XIII—REVENUE, HEALTH CARE, HUMAN RESOURCES, INCOME SEC- URITY, CUSTOMS AND TRADE, FOOD STAMP PROGRAM, AND TIMBER SALE PROVISIONS

## CHAPTER 1—REVENUE PROVISIONS

### SEC. 13001. SHORT TITLE; ETC.

(a) SHORT TITLE.—This chapter may be cited as the “Revenue Reconciliation Act of 1993”.

\* \* \* \* \*

### Subchapter A—Training and Investment Incentives

\* \* \* \* \*

## PART IV—INCENTIVES FOR INVESTMENT IN REAL ESTATE

### Subpart A—Extension of Qualified Mortgage Bonds and Low-Income Housing Credit

\* \* \* \* \*

#### SEC. 13142. LOW-INCOME HOUSING CREDIT.

(a) \* \* \*

(b) MODIFICATIONS.—

(1) \* \* \*

\* \* \* \* \*

(6) EFFECTIVE DATES.—

(A) \* \* \*

[(B) WAIVER AUTHORITY AND PROHIBITED DISCRIMINATION.—The amendments made by paragraphs (3) and (4) shall take effect on the date of the enactment of this Act.]

(B) *FULL-TIME STUDENTS, WAIVER AUTHORITY, AND PROHIBITED DISCRIMINATION.*—*The amendments made by paragraphs (2), (3), and (4) shall take effect on the date of the enactment of this Act.*

(C) HOME ASSISTANCE.—The amendment made by paragraph [(2)] (5) shall apply to periods after the date of the enactment of this Act.

\* \* \* \* \*

### Subchapter B—Revenue Increases

## PART I—PROVISIONS AFFECTING INDIVIDUALS

### Subpart A—Rate Increases

\* \* \* \* \*

#### SEC. 13206. PROVISIONS TO PREVENT CONVERSION OF ORDINARY INCOME TO CAPITAL GAIN.

(a) INTEREST EMBEDDED IN FINANCIAL TRANSACTIONS.—

(1) \* \* \*

\* \* \* \* \*

(3) EFFECTIVE DATE.—The amendments made by this [section] *subsection* shall apply to conversion transactions entered into after April 30, 1993.

\* \* \* \* \*

### Subpart B—Other Provisions

\* \* \* \* \*



**SEC. 13215. SOCIAL SECURITY AND TIER 1 RAILROAD RETIREMENT BENEFITS.**

(a) \* \* \*

\* \* \* \*

(c) TRANSFERS TO THE HOSPITAL INSURANCE TRUST FUND.—

(1) IN GENERAL.—Paragraph (1) of section 121(e) of the Social Security Amendments of 1983 (**[Public Law 92–21]** *Public Law 98–21*) is amended by—

(A) \* \* \*

\* \* \* \*

**PART VI—TREATMENT OF INTANGIBLES****SEC. 13261. AMORTIZATION OF GOODWILL AND CERTAIN OTHER INTANGIBLES.**

(a) \* \* \*

\* \* \* \*

(g) EFFECTIVE DATE.—

(1) \* \* \*

(2) ELECTION TO HAVE AMENDMENTS APPLY TO PROPERTY ACQUIRED AFTER JULY 25, 1991.—

(A) IN GENERAL.—If an election under this paragraph applies to the taxpayer—

(i) \* \* \*

\* \* \* \*

(iii) in applying subsection (f)(9) of such section, with respect to any property acquired **[by the taxpayer]** *by the taxpayer or a related person* on or before the date of the enactment of this Act, only holding or use on July 25, 1991, shall be taken into account.

\* \* \* \*

**Subchapter C—Empowerment Zones, Enterprise Communities, Rural Development Investment Areas, Etc.**

\* \* \* \*

**PART II—CREDIT FOR CONTRIBUTIONS TO CERTAIN COMMUNITY DEVELOPMENT CORPORATIONS****SEC. 13311. CREDIT FOR CONTRIBUTIONS TO CERTAIN COMMUNITY DEVELOPMENT CORPORATIONS.**

(a) \* \* \*

\* \* \* \*

(e) SELECTED COMMUNITY DEVELOPMENT CORPORATIONS.—

(1) \* \* \*

(2) ONLY 20 CORPORATIONS MAY BE SELECTED.—The Secretary of Housing and Urban Development may select 20 corporations for purposes of this section, subject to the availability of eligible corporations. Such selections may be made only before July

1, 1994. At least 8 of the operational areas of the corporations selected must be rural areas (as defined by section **1393(a)(3)** *1393(a)(2)* of such Code).

\* \* \* \* \*

## Part V—Miscellaneous Provisions

\* \* \* \* \*

### SEC. 13443. CREDIT FOR PORTION OF EMPLOYER SOCIAL SECURITY TAXES PAID WITH RESPECT TO EMPLOYEE CASH TIPS.

(a) \* \* \*

\* \* \* \* \*

(d) **EFFECTIVE DATE.**—The amendments made by this section shall apply with respect to taxes paid after December 31, 1993, *with respect to services performed before, on, or after such date.*

\* \* \* \* \*

## SOCIAL SECURITY ACT

\* \* \* \* \*

### TITLE II—FEDERAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE BENEFITS

\* \* \* \* \*

#### DEFINITION OF WAGES

SEC. 209. (a) For the purposes of this title, the term “wages” means remuneration paid prior to 1951 which was wages for the purposes of this title under the law applicable to the payment of such remuneration, and remuneration paid after 1950 for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that, in the case of remuneration paid after 1950, such term shall not include—

(1) \* \* \*

\* \* \* \* \*

(4) Any payment made to, or on behalf of, an employee or his beneficiary (A) from or to a trust exempt from tax under section 165(a) of the Internal Revenue Code of 1939 at the time of such payment or, in the case of a payment after 1954, under sections 401 and 501(a) of the Internal Revenue Code of 1954 or the Internal Revenue Code of 1986, unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust, or (B) under or to an annuity plan which, at the time of such payment, meets the requirements of section 165(a)(3), (4), (5), and (6) of the Internal Revenue Code of 1939 or, in the case of a payment after 1954 and prior to 1963, the requirements of section 401(a)(3), (4), (5), and (6) of the Internal Revenue Code of 1954, or (C) under or to an annuity plan which, at the time of any such payment after 1962, is a plan described

in section 403(a) of the Internal Revenue Code of 1986, or (D) under or to a bond purchase plan which, at the time of any such payment after 1962, is a qualified bond purchase plan described in section 405(a) of the Internal Revenue Code of 1954 (as in effect before the enactment of the Tax Reform Act of 1984), or (E) under or to an annuity contract described in section 403(b) of the Internal Revenue Code of 1986, other than a payment for the purchase of such contract which is made by reason of a salary reduction agreement (whether evidenced by a written instrument or otherwise), or (F) under or to an exempt governmental deferred compensation plan (as defined in section 3121(v)(3) of such Code), or (G) to supplement pension benefits under a plan or trust described in any of the foregoing provisions of this subsection to take into account some portion or all of the increase in the cost of living (as determined by the Secretary of Labor) since retirement but only if such supplemental payments are under a plan which is treated as a welfare plan under section 3(2)(B)(ii) of the Employee Retirement Income Security Act of 1974, or (H) under a simplified employee pension (as defined in section 408(k)(1) of such Code), other than any contributions described in section 408(k)(6) of such Code, (I) under a cafeteria plan (within the meaning of section 125 of the Internal Revenue Code of 1986) if such payment would not be treated as wages without regard to such plan and it is reasonable to believe that (if section 125 applied for purposes of this section) section 125 would not treat any wages as constructively received, or (J) *under an arrangement to which section 408(p) of such Code applies, other than any elective contributions under paragraph (2)(A)(i) thereof;*

\* \* \* \* \*

#### DEFINITION OF EMPLOYMENT

SEC. 210. For the purposes of this title—

##### Employment

(a) The term “employment” means any service performed after 1936 and prior to 1951 which was employment for the purposes of this title under the law applicable to the period in which such service was performed, and any service, of whatever nature, performed after 1950 (A) by an employee for the person employing him, irrespective of the citizenship or residence of either, (i) within the United States, or (ii) on or in connection with an American vessel or American aircraft under a contract of service which is entered into within the United States or during the performance of which and while the employee is employed on the vessel or aircraft it touches at a port in the United States, if the employee is employed on and in connection with such vessel or aircraft when outside the United States, or (B) outside the United States by a citizen or resident of the United States as an employee (i) of an American employer (as defined in subsection (e) of this section), or (ii) of a foreign affiliate (as defined in section 3121(l)(6) of the Internal Revenue Code of 1986 of an American employer during any period for which there is in effect an agreement, entered into pursuant to sec-

tion 3121(l) of such Code, with respect to such affiliate, or (C) if it is service, regardless of where or by whom performed, which is designated as employment or recognized as equivalent to employment under an agreement entered into under section 233; except that, in the case of service performed after 1950, such term shall not include—

(1) \* \* \*

\* \* \* \* \*

(20) Service (other than service described in paragraph (3)(A)) performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life under an arrangement with the owner or operator of such boat pursuant to which—

[(A) such individual does not receive any cash remuneration (other than as provided in subparagraph (B)),]

(A) *such individual does not receive any additional compensation other than as provided in subparagraph (B) and other than cash remuneration—*

*(i) which does not exceed \$100 per trip;*

*(ii) which is contingent on a minimum catch; and*

*(iii) which is paid solely for additional duties (such as mate, engineer, or cook) for which additional cash remuneration is traditional in the industry,*

\* \* \* \* \*

*For purposes of paragraph (20), the operating crew of a boat shall be treated as normally made up of fewer than 10 individuals if the average size of the operating crew on trips made during the preceding 4 calendar quarters consisted of fewer than 10 individuals.*

\* \* \* \* \*

## TAX REFORM ACT OF 1986

\* \* \* \* \*

# TITLE XI—PENSIONS AND DEFERRED COMPENSATION; EMPLOYEE BENEFITS; EMPLOYEE STOCK OWNERSHIP PLANS

## Subtitle A—Pensions and Deferred Compensation

\* \* \* \* \*

## PART II—NONDISCRIMINATION REQUIREMENTS

\* \* \* \* \*

**SEC. 1114. DEFINITION OF HIGHLY COMPENSATED EMPLOYEE.**

(a) \* \* \*

\* \* \* \* \*

(c) EFFECTIVE DATE.—

(1) \* \* \*

\* \* \* \* \*

(4) SPECIAL RULE FOR DETERMINING HIGHLY COMPENSATED EMPLOYEES.—For purposes of sections 401(k) and 401(m) of the Internal Revenue Code of 1986, in the case of an employer incorporated on December 15, 1924, if more than 50 percent of its employees in the top-paid group (within the meaning of section 414(q)(4) of such Code) earn less than \$25,000 (indexed at the same time and in the same manner as under section 415(d) of such Code), then the highly compensated employees shall include employees described in section 414(q)(1)(C) of such Code determined without regard to the level of compensation of such employees. *Any reference in this paragraph to section 414(q) shall be treated as a reference to such section as in effect on the day before the date of the enactment of the Small Business Job Protection Act of 1996.*

\* \* \* \* \*

**TITLE XIII—TAX-EXEMPT BONDS**

\* \* \* \* \*

**Subtitle B—Effective Dates and Transitional Rules**

\* \* \* \* \*

**SEC. 1317. TRANSITIONAL RULES FOR SPECIFIC FACILITIES.**

(1) \* \* \*

\* \* \* \* \*

(3) SPORTS FACILITIES.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide sports facilities (within the meaning of section 103(b)(4)(B) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facilities are described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if it is a stadium—

(i) \* \* \*

\* \* \* \* \*

The aggregate face amount of bonds to which this subparagraph applies shall not exceed \$200,000,000. *A facility shall not fail to be treated as described in this subparagraph by reason of an assignment (or an agreement to an assignment) by the governmental unit on whose behalf the*

*bonds are issued of any part of its interest in the property financed by such bonds to another governmental unit.*

\* \* \* \* \*

## SECTION 767 OF THE URUGUAY ROUND AGREEMENTS ACT

### SEC. 767. SINGLE SUM DISTRIBUTIONS.

(a) \* \* \*

\* \* \* \* \*

(d) EFFECTIVE DATE.—

(1) \* \* \*

\* \* \* \* \*

(3) SECTION 415.—

[(A) NO REDUCTION REQUIRED.—An accrued benefit shall not be required to be reduced below the accrued benefit as of the last day of the last plan year beginning before January 1, 1995, merely because of the amendments made by subsection (b).]

(A) *EXCEPTION.*—A plan that was adopted and in effect before December 8, 1994, shall not be required to apply the amendments made by subsection (b) with respect to benefits accrued before the earlier of—

(i) the later of the date a plan amendment applying such amendment is adopted or made effective, or

(ii) the first day of the first limitation year beginning after December 31, 1999.

*Determinations under section 415(b)(2)(E) of the Internal Revenue Code of 1986 before such earlier date shall be made with respect to such benefits on the basis of such section as in effect on December 7, 1994 (except that the modification made by section 1449(b) of the Small Business Job Protection Act of 1996 shall be taken into account), and the provisions of the plan as in effect on December 7, 1994, but only if such provisions of the plan meet the requirements of such section (as so in effect).*

\* \* \* \* \*

## REVENUE RECONCILIATION ACT OF 1990

## TITLE XI—REVENUE PROVISIONS

### SEC. 11001. SHORT TITLE; ETC.

(a) SHORT TITLE.—This title may be cited as the “Revenue Reconciliation Act of 1990”.

\* \* \* \* \*

## Subtitle B—Excise Taxes

\* \* \* \* \*

### PART II—USER-RELATED TAXES

\* \* \* \* \*

#### SEC. 11212. IMPROVEMENTS IN ADMINISTRATION OF GASOLINE EXCISE TAX.

(a) \* \* \*

\* \* \* \* \*

(e) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) **【**Paragraph (1) of section 6724(d)**】** *Subparagraph (B) of section 6724(d)(1)* is amended by striking “or” at the end of clause (x), by striking “, or subsection (e),” in clause (xi), by striking the period at the end of clause (xi) and inserting “, or”, and by inserting after clause (xi) the following new clause:

“(xii) section 4101(d) (relating to information reporting with respect to fuels taxes).”

\* \* \* \* \*

## Subtitle G—Tax Technical Corrections

\* \* \* \* \*

#### SEC. 11701. AMENDMENTS RELATED TO REVENUE RECONCILIATION ACT OF 1989.

(a) AMENDMENTS RELATED TO SECTION 7108.—

(1) \* \* \*

\* \* \* \* \*

**【**(11) Paragraph (2) of section 7108(r) of the Revenue Reconciliation Act of 1989 is amended by inserting before the period “but only with respect to bonds issued after such date”.**】**

\* \* \* \* \*

(f) AMENDMENT RELATED TO SECTION 7401.—Paragraph (2) of section 6038(e) (*relating to definitions*) is amended by adding at the end thereof the following new sentence: “In the case of a specified foreign corporation (as defined in section 898), the taxable year of such corporation shall be treated as its annual accounting period.”

\* \* \* \* \*

---

## EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

\* \* \* \* \*

## TITLE I—PROTECTION OF EMPLOYEE BENEFIT RIGHTS

## SUBTITLE A—GENERAL PROVISIONS

\* \* \* \* \*

## DEFINITIONS

SEC. 3. For purposes of this title:

(1) \* \* \*

\* \* \* \* \*

(37)(A) \* \* \*

\* \* \* \* \*

(F)(i) \* \* \*

(ii) *For purposes of the Internal Revenue Code of 1986—*

(I) *clause (i) shall apply, and*

(II) *a qualified football coaches plan shall be treated as a multiemployer collectively bargained plan.*

[(ii)] (iii) For purposes of this subparagraph, the term “qualified football coaches plan” means any defined contribution plan which is established and maintained by an organization—

(I) which is described in section 501(c) of such Code;

(II) the membership of which consists entirely of individuals who primarily coach football as full-time employees of 4-year colleges or universities described in section 170(b)(1)(A)(ii) of such Code; and

(III) which was in existence on September 18, 1986.

\* \* \* \* \*

## PART 6—GROUP HEALTH PLANS

## GROUP HEALTH PLANS

\* \* \* \* \*

## SEC. 602. CONTINUATION COVERAGE.

For purposes of section 601, the term “continuation coverage” means coverage under the plan which meets the following requirements:

(1) \* \* \*

(2) PERIOD OF COVERAGE.—The coverage must extend for at least the period beginning on the date of the qualifying event and ending not earlier than the earliest of the following:

(A) MAXIMUM REQUIRED PERIOD.—

(i) \* \* \*

\* \* \* \* \*

[(v)] QUALIFYING EVENT INVOLVING MEDICARE ENTITLEMENT.—In the case of an event described in section 603(4) (without regard to whether such event is a qualifying event), the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event shall not terminate before the close of the 36-month period beginning on the date the covered employee becomes enti-



tled to benefits under title XVIII of the Social Security Act.]

(v) *MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.*—*In the case of a qualifying event described in section 603(2) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than the covered employee shall not terminate under this subparagraph before the close of the 36-month period beginning on the date the covered employee became so entitled.*

In the case of an individual who is determined, under title II or XVI of the Social Security Act, to have been disabled at the time of a qualifying event described in section 603(2), any reference in clause (i) or (ii) to 18 months with respect to such event is deemed a reference to 29 months, but only if the qualified beneficiary has provided notice of such determination under section 606(3) before the end of such 18 months.

\* \* \* \* \*

## SECTION 2202 OF THE PUBLIC HEALTH SERVICE ACT

### SEC. 2202. CONTINUATION COVERAGE.

For purposes of section 2201, the term “continuation coverage” means coverage under the plan which meets the following requirements:

(1) \* \* \*

(2) PERIOD OF COVERAGE.—The coverage must extend for at least the period beginning on the date of the qualifying event and ending not earlier than the earliest of the following:

(A) MAXIMUM REQUIRED PERIOD.—

(i) \* \* \*

\* \* \* \* \*

[(iv) QUALIFYING EVENT INVOLVING MEDICARE ENTITLEMENT.—In the case of an event described in section 2203(4) (without regard to whether such event is a qualifying event), the period of coverage for qualified beneficiaries other than the covered employee for such event or any subsequent qualifying event shall not terminate before the close of the 36-month period beginning on the date the covered employee becomes entitled to benefits under title XVIII of the Social Security Act.]

(iv) *MEDICARE ENTITLEMENT FOLLOWED BY QUALIFYING EVENT.*—*In the case of a qualifying event described in section 2203(2) that occurs less than 18 months after the date the covered employee became entitled to benefits under title XVIII of the Social Security Act, the period of coverage for qualified beneficiaries other than*

*the covered employee shall not terminate under this subparagraph before the close of the 36-month period beginning on the date the covered employee became so entitled.*

\* \* \* \* \*

## OMNIBUS BUDGET RECONCILIATION ACT OF 1989

\* \* \* \* \*

## TITLE VI—MEDICARE, MEDICAID, MATERNAL AND CHILD HEALTH, AND OTHER HEALTH PROVISIONS

\* \* \* \* \*

### Subtitle E—Provisions With Respect to COBRA Continuation Coverage

#### PART 1—EXTENSION OF COVERAGE FOR DISABLED EMPLOYEES

\* \* \* \* \*

#### SEC. 6701. EXTENSION, UNDER INTERNAL REVENUE CODE, OF COVERAGE FROM 18 TO 29 MONTHS FOR THOSE WITH A DISABILITY AT TIME OF TERMINATION OF EMPLOYMENT.

(a) IN GENERAL.—Paragraph (2)(B) of section 4980B(f) of the Internal Revenue Code of 1986, as added by section 3011(a) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647), (relating to maximum required period of continuation coverage), is amended—

(1) in clause (i) by adding after and below subclause [(IV)] (V) the following new sentence:

“In the case of a qualified beneficiary who is determined, under title II or XVI of the Social Security Act, to have been disabled at the time of a qualifying event described in paragraph (3)(B), any reference in subclause (I) or (II) to 18 months with respect to such event is deemed a reference to 29 months, but only if the qualified beneficiary has provided notice of such determination under paragraph (6)(C) before the end of such 18 months.”; and

\* \* \* \* \*

## TITLE VII—REVENUE MEASURES

\* \* \* \* \*

## Subtitle C—Employee Benefit Provisions

### PART I—EMPLOYEE STOCK OWNERSHIP PLANS

\* \* \* \* \*

#### SEC. 7304. REPEAL OF CERTAIN PROVISIONS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS.

##### (a) ESTATE TAX DEDUCTION.—

(1) \* \* \*

##### (2) CONFORMING AMENDMENTS.—

(A) \* \* \*

\* \* \* \* \*

##### (D) Section 4979A is amended—

(i) by striking “or section 2057” in subsection (b)(1), and

(ii) by striking “or section 2057(d)” in subsection [(c)(2)] (c).

\* \* \* \* \*

## Subtitle F—Miscellaneous Provisions

\* \* \* \* \*

### PART V—OTHER PROVISIONS

\* \* \* \* \*

#### SEC. 7646. REPORTING OF POINTS ON MORTGAGE LOANS.

##### (a) \* \* \*

##### (b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section [6050H(b)(1)] 6050H(b)(2) is amended by inserting “(other than points)” after “such interest”.

\* \* \* \* \*

## Subtitle G—Revision of Civil Penalties

\* \* \* \* \*

### PART II—REVISION OF ACCURACY-RELATED PENALTIES

#### SEC. 7721. REVISION OF ACCURACY-RELATED PENALTIES.

##### (a) \* \* \*

\* \* \* \* \*

##### (c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) \* \* \*

\* \* \* \* \*

(10) Subparagraph (C) of section 461(i)(3) is amended by striking “section **【6662(b)(2)(C)(ii)】** *6661(b)(2)(C)(ii)*” and inserting “section 6662(d)(2)(C)(ii)”.

\* \* \* \* \*

## Subtitle H—Technical Corrections

\* \* \* \* \*

## PART I—AMENDMENTS RELATED TO TECHNICAL AND MISCELLANEOUS REVENUE ACT OF 1988

### SEC. 7811. AMENDMENTS RELATED TO TITLE I OF THE 1988 ACT.

(a) \* \* \*

\* \* \* \* \*

(i) AMENDMENTS RELATED TO SECTION 1012 OF THE 1988 ACT.—

(1) \* \* \*

\* \* \* \* \*

(3) Subparagraph (A) of section 954(c)(3) is amended—

(A) by striking “is created” *the first place it appears* in clause (i) and inserting “is a corporation created”,

\* \* \* \* \*

## PART IV—MISCELLANEOUS CHANGES

### SEC. 7841. MISCELLANEOUS CHANGES.

(a) \* \* \*

\* \* \* \* \*

(d) MISCELLANEOUS CLERICAL CHANGES.—

(1) \* \* \*

\* \* \* \* \*

(10) Paragraph (27) of section **【381(a)】** *381(c)* (relating to credit under section 53) is redesignated as paragraph (26).

\* \* \* \* \*

## PART V—AMENDMENTS RELATED TO PENSION PROVISIONS

\* \* \* \* \*

**Subpart A—Amendments Related To Tax Reform  
Act of 1986**

**SEC. 7861. AMENDMENTS RELATED TO TITLE XI OF THE REFORM  
ACT.**

(a) \* \* \*

\* \* \* \* \*

(c) AMENDMENTS RELATED TO SECTION 1140 OF THE REFORM  
ACT.—

(1) \* \* \*

(2) Section 1140(c) of the Reform Act is amended by striking  
all after “the first plan year beginning” *the second place it ap-*  
*pears* and inserting “after the later of—

“(1) December 31, 1988, or

“(2) the earlier of—

“(A) December 31, 1990, or

“(B) the date on which the last of such collective bar-  
gaining agreements terminate (without regard to any ex-  
tension after February 28, 1986).”

\* \* \* \* \*

## **VII. SUPPLEMENTAL VIEWS OF DEMOCRATIC MEMBERS OF THE COMMITTEE ON WAYS AND MEANS ON H.R. 3448**

After many months of strong opposition to legislation that would increase the minimum hourly wage from \$4.25 to \$5.15 over two years, Republicans have indicated they will consider wage legislation only if they are allowed to include tax benefits for business. Even though we favor expanded investment incentives and simplified rules for small business, we prefer not to endanger the passage of an increase in the minimum wage by linking it to unrelated issues.

Some Republicans have argued that minimum wage concerns should not be taken seriously since workers living on these low wages do not exist. We know differently; these workers are real people; they do exist; many of them have families; many of them are struggling to make ends meet. These people are not seeking government hand-outs. They merely seek a way to keep their heads above water, food on the table, and shelter. They also seek an opportunity to improve their status in life.

However, our major regret over most of the tax provisions contained in the bill is that we were not permitted to reach a bipartisan consensus on the details of the provisions that we all support. We think this bill should help the workers and their families as well as business owners.

During Committee consideration of this bill, we attempted to improve the bill for workers and their families. Our Republican Members rejected amendments which would have (1) improved educational opportunities for American workers and low- and middle-income families and (2) enhanced financial stability for the long-term unemployed.

### ***Improved educational opportunity needs more than lip service to become a reality***

Under the bill, the provision to provide tax-free employer-provided educational assistance would be extended from January 1, 1995, through December 31, 1996. However educational expenses for graduate studies would not receive the exclusion after December 31, 1995. We question the intelligence of this decision. The Republicans argue that their primary concern here is to provide more Americans with the opportunity to obtain a basic education at the undergraduate level before resources can be committed for graduate studies. Given the advanced knowledge of technology that is required by many of today's jobs, it is more important than ever that our American workers receive higher education. If employers are willing to foot the bill, can we as a national fail to encourage the effort?

During consideration of H.R. 3448, Republicans were given the opportunity to approve an amendment, originally proposed by

President Clinton, that would have allowed taxpayers with income below \$70,000 (single return) and \$120,000 (joint return) to deduct up to \$5,000 of educational expenses. Republicans argued that because the benefit would not be available to taxpayers at all income levels, they could not support the amendment. We cannot endorse such policies. In a time of limited Resources, our Republican colleagues have refused to set priorities based on areas of greatest need. Republicans continue to demonstrate that any tax benefits they support for low- and middle-income taxpayers must trickle down from benefits bestowed upon the high-income taxpayers.

In addition, the fallacy of the argument espoused by Republicans in support of the repeal of the benefit for graduate studies must be questioned. If the true reason for this repeal is to give priority to providing a basic undergraduate education to a greater number of workers and families, what happened to this commitment when the Republicans were presented with the perfect opportunity to lend credence to this claim? How do they explain their failure to provide approximately 17 million students with a modest deduction for educational expenses incurred in obtaining the basic undergraduate education? What alternative do they offer? Let us remind ourselves that this bill is intended to include benefits for "small" businesses and the employees of those businesses. In the area of education, it fails.

The need for continuing education has never been more real and evident in our country than today. Technological advances outpace the ability of employers and workers to maintain a leading competitive edge in the world today. The world economy mandates that substantial resources be committed to the continuing training and education of our workers. This effort cannot be executed efficiently if it must be undertaken solely by employers.

Data on the employer-provided educational assistance benefit indicate that most employees who are receiving employer-provided graduate education are studying business education; health-related courses are second; and engineering is third. We have been unable to uncover any evidence to support the Republican claim that graduate level benefits should not be allowed because they are used primarily by individuals who become doctors and lawyers. We cannot argue that this does not occur occasionally, but are we prepared to "throw the baby out with the bath water" at a time when this benefit is needed more than ever? We implore our Republican colleagues to reconsider their position on this issue.

It was argued that the employer-provided educational assistance benefit must be modified because it gives an unfair advantage to the worker whose employer offers this benefit over the worker whose employer does not offer the benefit. We must ask, if this is truly a concern why not support the effort to provide these workers with the benefit of a \$5,000 deduction for their educational expense? Moreover, should we be concerned over the total elimination of this benefit the next time around? At one point during consideration of this bill, five Republicans joined us in adding back graduate education benefits to the exclusion. For one fleeting moment, we delighted in the fact that this Committee had set aside partisanship and accomplished good policy. However, our pride in the Committee was short-lived for within an hour of the first vote

every Republican Member voted to reconsider the earlier vote and then voted against the graduate education benefit.

***Where is the concern for the long-term unemployed?***

We were also disappointed when our Republican colleagues turned their backs on a golden opportunity to permit long-term unemployed individuals, during periods of unemployment, to withdraw funds from their pension plans without paying the additional 10-percent tax.

The urgency of this provision confronts us every day as we hear from people who were once gainfully employed, saving for retirement, and providing adequately for the needs of their families. Then their employment was terminated. At the beginning of this process, the worker is optimistic because he or she has some small savings to cover short-term emergencies. A few months go by and the reality of job hunting in today's market catches up with the individual. Unemployment benefits begin but at a level substantially below the worker's former salary. However, the rent or mortgage continue to be due every month, the utilities charges begin to fall into arrears; even with modification, the food bill becomes impossible for the family. This family is desperate and the only other available funds are invested in retirement savings. The family is now faced with the difficult choice of depleting some portion of its resources set aside for retirement. Under present law, withdrawals before age 59½ are not only subject to income tax on the withdrawn amount but also an additional 10-percent tax. This policy can become self-defeating. It must be evaluated in more realistic terms.

Our Republican colleagues have argued that this is not the time to support such a provision. We ask, if not now, when? How many more large-scale corporate restructuring deals must we read about before we hear the pleas of desperate individuals and families? Another argument raised by the Republicans in their defense of their position is that the provision would permit individuals to withdraw retirement funds for lavish Christmas shopping. We must strongly state our disagreement. We believe that if an employee has been conscientious enough to save for retirement, such an employee is not likely to deplete these resources willy-nilly.



In summary, we wish we had been allowed to help craft a bill to assist both businesses and workers. We believe a better product would have been reported from this Committee if such bipartisanship had prevailed.

SAM M. GIBBONS.  
CHARLES B. RANGEL.  
FORTNEY PETE STARK.  
HAROLD E. FORD.  
ROBERT T. MATSUI.  
BARBARA B. KENNELLY.  
WILLIAM J. COYNE.  
SANDER M. LEVIN.  
JIM McDERMOTT.  
GERALD D. KLECZKA.  
JOHN LEWIS.  
L.F. PAYNE.  
RICHARD E. NEAL.  
MICHAEL R. McNULTY.

## **VIII. DISSENTING VIEWS ON H.R. 3448 BY: REP. CHARLES B. RANGEL (D-NY)**

Although I may differ over some of the details, I support most of the provisions contained in the bill reported by the Committee. I do regret that the Committee was not permitted to reach a bipartisan consensus over the details of tax provisions that we all support. However, that is not the reason for my opposition to the bill. I oppose the bill reported by the Committee because the tax benefits it provides for small businesses and others are largely funded through revenues raised by modifications to the section 936 credit. I believe that those modifications will have an adverse impact on the economy of Puerto Rico and other possessions.

Section 936 has long been an important part of the economic development programs of Puerto Rico and the other possessions. We made substantial revisions to the section 936 credit in the 1993 Reconciliation Act with the purpose of focusing the benefits of that credit on companies with substantial economic activities in Puerto Rico. Before we have had an opportunity to analyze the impact of those changes on the economy of Puerto Rico and the other possessions, we are again considering substantial changes to section 936.

When one examines the details of the Committee bill, it becomes apparent that great care was taken to accommodate the interests of the companies currently operating in Puerto Rico. I only wish that similar care had been taken in assessing its impact on the economies of Puerto Rico and the other possessions. The fact that the individuals who could be directly and adversely affected by the Committee bill do not have voting representation in Congress requires us to be particularly sensitive to their interests.

For U.S. companies operating in Puerto Rico, section 936 generally eliminates the U.S. tax on their active business income in Puerto Rico (referred to as the active business credit) and on their income derived from certain passive investments in Puerto Rico (referred to as the QPSII credit).

The bill reported by Committee immediately terminates the QPSII credit without any serious examination of the adverse impact of such a change. Currently over one-third of the total bank deposits in Puerto Rico consists of investments eligible for the QPSII credit. Many of these deposits have short maturities and will likely be quickly withdrawn if the Committee bill becomes law. One can only speculate on the impact of such withdrawals on the banking system of Puerto Rico. The termination of the QPSII credit may have a dramatic impact on the Puerto Rican banking system but is a small inconvenience for the companies operating there. That inconvenience is offset by other provisions of the Committee bill that facilitate the accumulation of passive investment assets in foreign tax haven countries.

The Committee bill immediately terminates the section 936 active business credit for new investments in Puerto Rico. Under the committee bill, there will be no tax incentives for new business investments in Puerto Rico but there will be very generous transition rules for those companies who have claimed section 936 benefits in the past. Opponents of section 936 have argued that it provides overly generous tax benefits to a relatively small number of companies operating in Puerto Rico. Ironically, the companies currently enjoying those “over generous” benefits are generally supportive of the Committee bill because it provides them a generous ten-year transition period during which they will continue to enjoy most of those benefits.

I believe that we should consider modifications to the section 936 credit and other tax benefits to ensure that they are accomplishing their intended purpose. The Administration has a proposal that would continue the effort started in 1993 to focus the credit on companies with substantial economic activities in Puerto Rico. I believe that such an approach would eliminate the alleged abuses under the section 936 credit and would continue positive tax incentives for future business investments in Puerto Rico.

CHARLES B. RANGEL.

