104TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
104–84

CONTRACT WITH AMERICA TAX RELIEF ACT OF 1995

R E P O R T

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ON

H.R. 1215

together with

DISSENTING VIEWS

[Including cost estimate of the Congressional Budget Office]

MARCH 21, 1995.—Committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE

89–286 WASHINGTON : 1995

CONTENTS

104TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
104–84

CONTRACT WITH AMERICA TAX RELIEF ACT OF 1995

MARCH 21, 1995.—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

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 1215]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 1215) to amend the Internal Revenue Code of 1986 to strengthen the American family and create jobs, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

89–286

I. INTRODUCTION

A. Purpose and Summary

H.R. 1215, the "Contract With America Tax Relief Act of 1995," includes provisions derived from the revenue provisions contained in the "Contract With America" (the "Contract"), the "Tax Technical Corrections Act of 1995" (H.R. 1121), and certain other revenue proposals. The following is a title-by-title summary of the bill as reported.

Title I—American Dream Restoration

Family tax credit (sec. 101)

The bill provides families with an income tax credit of $500 for each qualifying child under age 18. The credit is phased out ratably for families with adjusted gross incomes between $200,000 and $250,000. The provision is effective for taxable years beginning after December 31, 1995. The credit amount and the phaseout threshold are indexed for inflation after 1996.

Credit to reduce the marriage penalty (sec. 102)

The bill provides married couples who file joint returns with an income tax credit of up to $145. The provision is effective for taxable years beginning after December 31, 1995.

American Dream Savings Accounts and deductible spousal IRAs (secs. 103–104)

The bill establishes a new savings vehicle, the American Dream Savings Account ("ADS account"), to which individuals are permitted to make annual nondeductible contributions of up to $2,000 ($4,000 for married couples filing joint returns). The annual limitation is indexed for inflation after 1996. Amounts withdrawn from a regular Individual Retirement Arrangement (IRA) can be rolled over to an ADS account between January 1, 1996 and December 31, 1997, with the amount included in gross income ratably over four years. Qualified distributions from an ADS account are not includible in gross income, and are not subject to the additional tax imposed on early withdrawals. A qualified distribution is a distribution that is made after five years and is (1) made on or after the individual attains age 59½; (2) made to a beneficiary (or the individual's estate) on or after the individual's death; (3) attributable to the individual's being disabled; or (4) is for a qualified special purpose, which includes the first-time purchase of a home or the payment of qualified higher education expenses, medical expenses, and long-term care insurance premiums.

The bill also modifies the present-law rules relating to deductible IRAs by permitting deductible IRA contributions of up to $2,000 for each spouse (including a homemaker who does not work outside the home) if the combined compensation of both spouses is at least equal to the contributed amount. The ADS and IRA provisions are effective for taxable years beginning after December 31, 1995.

Title II—Senior Citizens' Equity

Repeal of tax increase on Social Security benefits (sec. 201)

The bill repeals the 1993 increase in the amount of Social Security and Railroad Retirement Tier 1 benefits that are potentially subject to income taxation, reducing the amount from 85 percent to 50 percent over five years. The maximum percentage of Social Security benefits subject to tax is 75 percent in 1996, 65 percent in 1997, 60 percent in 1998, 55 percent in 1999, and 50 percent thereafter. The bill also phases in a reduction in the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of nonresident aliens. The bill also provides that revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the increased portion of benefits included in gross income under the Omnibus Budget Reconciliation Act of 1993 (as phased out under the provision) will be credited to the Old-Age and Survivors and Disability Insurance Trust Funds.

Treatment of long-term care insurance and services (secs. 211–214 and 231–232)

The bill provides tax incentives for the purchase of long-term care insurance contracts. The bill generally treats a long-term care insurance contract as an accident and health insurance contract. Amounts (other than policyholder dividends or premium refunds) received under a long-term care insurance contract are excludable as amounts received for personal injuries and sickness (up to $200 per day or $73,000 per year). A plan of an employer providing coverage under a long-term care insurance contract generally is treated as an accident and health plan; however, coverage under a long-term care insurance contract is not excludable by an employee if provided through a cafeteria plan and expenses for long-term care services cannot be reimbursed under a flexible spending arrangement. Within certain limits, premiums for long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses. Similarly, expenses for qualified long-term care services are treated as medical expenses for purposes of the itemized deduction. The long-term care provisions generally are effective for taxable years beginning after December 31, 1995.

In determining reserves for insurance company tax purposes, the bill provides that the Federal income tax reserve method for a long-term care insurance contract issued after December 31, 1995, generally is the method prescribed by the National Association of Insurance Commissioners. However, the tax reserve for a contract cannot exceed the amount taken into account in determining statutory reserves.

Tax treatment of accelerated death benefits under life insurance contracts (secs. 221–222)

The bill provides an exclusion from gross income for (1) amounts received under a life insurance contract and (2) amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured under the life insurance contract is either terminally ill or chronically ill. An individual is considered to be terminally ill if a physician certifies that the individual has an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of certification. An individual generally is considered to be chronically ill if a licensed health care practitioner certifies that the individual is unable to perform (without substantial assistance) at least two activities of daily living for at least 90 days due to a loss of functional capacity or cognitive impairment. With respect to a chronically ill individual (who is not also terminally ill), the $200 per day ($73,000 per year) limit on excludable long-term care benefits applies. The provision applies to amounts received after December 31, 1995.

Title III—Job Creation and Wage Enhancement

Capital gains provisions

The bill includes four general provisions affecting the tax treatment of capital gains and losses:

(1) *50-percent capital gains deduction for individuals (sec. 301)*

The bill allows individuals to deduct 50 percent of net capital gain for the taxable year, repeals the provisions in the Omnibus Budget Reconciliation Act of 1993 providing a capital gain exclusion for sales of certain small business stock, and reinstates the rule in effect prior to the l986 Tax Reform Act that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income continues to apply. Collectibles will not qualify for the 50-percent exclusion. However, an individual may elect to apply a maximum rate of 28 percent to the net capital gain attributable to collectibles, if the individual forgoes the benefit of indexing the basis of the collectible. The provision generally applies to taxable years ending after December 31, 1994.

(2) *Indexing of basis of certain assets for purposes of determining gain (sec. 302)*

The bill generally provides an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain (but not loss) upon a sale or other disposition of such assets by a taxpayer other than a C corporation. Indexed assets generally include common stock of C corporations and tangible property that is a capital asset or property used in a trade or business. To be eligible for indexing, an asset must be held by the taxpayer for more than three years. The provision is effective for assets acquired on or after January 1, 1995 (and to principal residences held on that date).

A taxpayer holding any indexed asset (other than a principal residence) on January 1, 1995, may elect to treat the indexed asset as having been sold on that date for an amount equal to its fair market value, and as having been reacquired for an amount equal to such value. If the election is made, the asset would be eligible for indexing under the provision.

(3) 25-percent corporate alternative tax for capital gains (sec. 311)

The bill provides an alternative tax of 25 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate. The provision generally applies to taxable years ending after December 31, 1994. For taxable years ending after December 31, 1994, and beginning before January 1, 1996, the 25-percent rate applies to the lesser of (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1994.

(4) Capital loss deduction allowed with respect to the sale or exchange of a principal residence (sec. 316)

The bill provides that a loss from the sale or exchange of a principal residence is treated as a deductible capital loss rather than a nondeductible personal loss. The provision is effective for sales and exchanges after December 31, 1994, in taxable years ending after such date.

Cost recovery provisions

Neutral cost recovery (sec. 321)

For any property that is currently eligible for depreciation under the modified Accelerated Cost Recovery System ("MACRS"), the bill allows a taxpayer to elect, on a property-by-property basis, to determine depreciation deductions under present law or under a new neutral cost recovery system ("NCRS"). NCRS generally follows MACRS but replaces the 200-percent declining balance method of MACRS applicable to shorter-lived property with the 150-percent declining balance method. In addition, depreciation deductions are increased to reflect inflation occurring since the property was placed in service, and, in the case of property that is currently eligible for the 200-percent declining balance method, an assumed 3.5-percent real rate of return. The depreciation allowances provided under NCRS for regular tax purposes also are applied for alternative minimum tax purposes. The NCRS election is available for qualifying property placed in service after December 31, 1994.

Treatment of leasehold improvements (sec. 322)

The bill provides that a lessor that disposes of a leasehold improvement at the end of a lease term is allowed to recover the adjusted basis of the improvement at that time. The provision is effective for leasehold improvements disposed of after March 13, 1995.

Alternative minimum tax (sec. 331)

The bill repeals the corporate alternative minimum tax for taxable years beginning after December 31, 2000, and modifies the individual alternative minimum tax. Business and corporate preferences and adjustments under the alternative minimum tax generally cease to apply after December 31, 1995 (March 13, 1995, in the case of depreciable property). For taxable years beginning after December 31, 1995, a taxpayer with alterative minimum tax credit carryovers is allowed to use these credits to offset 90 percent of its regular tax liability (determined after the application of other credits). In no event can alternative minimum tax credit carryovers be used to reduce the taxpayer's tax liability below its tentative minimum tax, if any.

Public debt reduction checkoff and trust fund (secs. 341-342)

The bill permits individual taxpayers to designate an amount up to 10 percent of their Federal income tax liability for a taxable year to be earmarked to reduce the Federal public debt. Amounts earmarked by taxpayers to reduce the public debt will be transferred into a Public Debt Reduction Trust Fund, which will be used only to retire or purchase Federal securities. Related provisions (outside the jurisdiction of the committee and, thus, not included in the bill) would require either specific spending cuts or an across-the-board sequestration in Federal spending (with certain exceptions) to match the amounts designated by taxpayers for debt reduction. The provision is effective for taxable years ending after the date of enactment, and will remain in effect until the entire outstanding Federal public debt is retired.

Small business incentives

Increase in unified estate and gift tax credits; indexing of certain provisions (sec. 351)

The bill increases the present-law unified credit from an amount that effectively exempts $600,000 in taxable transfers from the estate and gift tax to an amount that effectively exempts taxable transfers of $750,000. The increase is phased in to exempt taxable transfers of $700,000 in 1996, $725,000 in 1997, and $750,000 in 1998. After 1998, the $750,000 exclusion amount is indexed for inflation. These revisions apply to the estates of decedents dying, and gifts made, after December 31, 1995.

The bill also indexes the following amounts for inflation beginning after 1998: (1) the $10,000 annual exclusion for gifts; (2) the $750,000 ceiling amount on special use valuation under Code section 2032A; (3) the $1,000,000 generation-skipping transfer tax exemption; and (4) the value of a closely-held business (i.e., $1,000,000) eligible for the special four-percent interest rate under Code section 6601(j).

Increase in expensing for small businesses (sec. 352)

The bill increases the $17,500 amount that a small business is allowed to expense under Code section 179 to $35,000. The increase is phased in as follows: $22,500 for property placed in service in taxable years beginning in 1996; $27,500 for taxable years beginning in 1997; $32,500 for taxable years beginning in 1998; and, $35,000 for taxable years beginning after 1998.

Clarification of definition of principal place of business; Treatment of storage of product samples (secs. 353–354)

The bill provides that a home office qualifies as a taxpayer's "principal place of business" if (1) the office is used by the taxpayer to conduct administrative or management activities for a trade or business and (2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. The bill also clarifies that deductions are permitted 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. The provision applies to taxable years beginning after 1995.

Title IV—Family Reinforcement

Tax credit for adoption expenses (sec. 401)

The bill provides taxpayers with an income tax credit of up to $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. The credit is phased out ratably for taxpayers with adjusted gross income between $60,000 and $100,000. The credit is available for taxable years beginning after December 31, 1995.

Tax credit for custodial care of certain elderly family members in taxpayer's home (sec. 402)

The bill provides an income tax credit of $500 for each qualified family member. Generally, a qualified family member is a parent or grandparent who lives with the taxpayer and is physically or mentally incapable of caring for himself or herself. The provision is effective for taxable years beginning after December 31, 1995.

Title V—Increase in the Social Security Earnings Limit

The bill increases the amount that an individual between age 65 and 69 may earn while retaining full eligibility for Social Security benefits (the "earnings limit") from $11,280 to $30,000. The increase is phased in over five years as follows: $15,000 in 1996; $19,000 in 1997; $23,000 in 1998; $27,000 in 1999; and $30,000 in 2000. Senior citizens age 65 to 69 who earn more than the specified earnings limit for the year will continue to lose $1 in benefits for every $3 earned over the limit.

Title VI—Tax Technical Corrections

The bill incorporates (with modifications) the "Tax Technical Corrections Act of 1995," previously introduced separately as H.R. 1121 by Chairman Archer and Mr. Gibbons on March 3, 1995. The bill modifies H.R. 1121 by deleting two provisions ((1) section 2(a)(3) (relating to correction of head of household rate table for proper indexation) and (2) section 3(f)(1) (relating to treatment of certain nonqualified withdrawals from Merchant Marine capital construction funds)), and by adding new clerical corrections.

B. Background and Need for Legislation

The "Contract With America Tax Relief Act of 1995", H.R. 1215, includes provisions derived from the revenue provisions contained in the "Contract With America" (the "Contract"), as well as the Tax Technical Corrections Act of 1995 (H.R. 1121) and certain other revenue proposals. The Contract was signed by over 300 Republican House candidates and incumbents on September 27, 1994, as an agenda for the first 100 days of the 104th Congress. The Contract was introduced when the 104th Congress convened on January 4, 1995, and included four bills containing various tax proposals: H.R. 6 ("American Dream Restoration Act"); H.R. 8 ("Senior Citizens' Equity Act"); H.R. 9 ("Job Creation and Wage Enhancement Act"); and H.R. 11 ("Family Reinforcement Act").

The revenue provisions in the Contract are designed to strengthen the American family by reducing the tax burden on families with children and on two-earner married couples, and by providing tax incentives for families to adopt children and care for elderly relatives. The bill also includes provisions to encourage savings and capital investment, expand entrepreneurship, encourage taxpayers to designate funds to reduce the national debt, reduce the estate and gift tax burden, and alleviate the tax burden on the elderly. The reductions in tax on savings and investment are designed to allow individuals and businesses to retain funds needed for savings and investment, leading to job creation as well as more efficient economic productivity and growth.

C. Legislative History

Committee Bill

H.R. 1215 ("Contract With America Tax Relief Act of 1995") was introduced by Committee on Ways and Means Chairman Archer on March 13, 1995. The bill contains six titles and includes provisions derived from the revenue provisions in the "Contract With America" (the "Contract"), as well as certain other revenue provisions.

The Contract's legislative proposals were introduced on January 4, 1995, and included four bills that contain various revenue proposals: H.R. 6 ("American Dream Restoration Act"); H.R. 8 ("Senior Citizens' Equity Act"); H.R. 9 ("Job Creation and Wage Enhancement Act"); and H.R. 11 ("Family Reinforcement Act").[1]

Title I of H.R. 1215 relates to revenue provisions derived from the American Dream Restoration Act; Title II relates to revenue provisions derived from the Senior Citizens' Equity Act; Title III relates to revenue provisions derived from the Job Creation and Wage Enhancement Act, with additional provisions regarding a 25-percent corporate alternative tax for capital gains, the tax treatment of leasehold improvements, and the alternative minimum tax; Title IV relates to revenue provisions derived from the Family Reinforcement Act; Title V relates to a provision to increase the social

[1] For a description of the revenue provisions contained in these four bills, see Joint Committee on Taxation, *Description of Tax Proposals Contained in the "Contract With America" (H.R. 6, H.R. 9, H.R. 8, and H.R. 11)* (JCS–1–95), January 9, 1995.

security earnings limit derived from the Senior Citizens' Equity Act; and Title VI relates to the provisions of H.R. 1121, the "Tax Technical Corrections Act of 1995," introduced on March 3, 1995, with certain modifications.

The Committee on Ways and Means marked up H.R. 1215 on March 14, 1995, and ordered the bill favorably reported without amendment by a recorded vote of 21–14.

Committee Hearings

Full Committee hearings

The Committee on Ways and Means held overview hearings on the Contract provisions within its jurisdiction on January 5 and 10–12, 1995.[2] On January 17–18, 1995, the Committee held hearings on Contract provisions relating to taxation of the family: tax credit for families with children, marriage penalty tax relief, tax credit for adoption expenses, and tax credit for home care of elderly family members. On January 19, 1995, the Committee held a hearing on two tax provisions in the Senior Citizens' Equity Act: repeal of the income tax increase on Social Security benefits and allowance of tax-free death benefits under life insurance contracts.

The Committee held hearings on January 24–26 and 31 and February 1, 1995, on tax incentive provisions relating to savings and investment: the American Dream Savings Account provision in the American Dream Restoration Act and tax reductions in the Job Creation and Wage Enhancement Act (capital gains tax reductions, neutral cost recovery, increased expensing for small business, increased estate and gift tax unified credit, and the deduction for home office expenses). The Committee also held hearings on revenue proposals in the President's fiscal year 1996 budget on February 7–9, 1995.

Subcommittee hearings

The Subcommittee on Social Security held a hearing on January 9, 1995, on the Social Security earnings limit provision of the Contract (in the Senior Citizens' Equity Act). On January 20, 1995, the Subcommittee on Health held a hearing on tax incentives for long-term care insurance (in the Senior Citizens' Equity Act).

[2] For a summary of the Contract provisions within the Committee's jurisdiction, see Committee on Ways and Means, *Description of Provisions in the Contract With America Within the Jurisdiction of the Committee on Ways and Means* (WMCP:104–1), January 5, 1995.

II. EXPLANATION OF PROVISIONS

TITLE I. AMERICAN DREAM RESTORATION

A. Family Tax Credit (sec. 101 of the bill and new sec. 23 of the Code)

Present Law

Present law does not provide tax credits based solely on the number of dependent children. Taxpayers with dependent children, however, generally are able to claim a personal exemption for each of these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,500 for 1995, and is adjusted annually for inflation. The amount of the personal exemption is phased out for taxpayers with AGI in excess of $114,700 for single taxpayers, $143,350 for heads of household, and $172,050 for married couples filing joint returns.

In addition, eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children, and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. In 1995, the maximum credit is $3,112 for taxpayers with more than one qualifying child, $2,093 for taxpayers with one qualifying child, and $314 for taxpayers with no qualifying children. For taxpayers with earned income (or AGI, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or AGI, if greater) exceeds the phaseout limit. In 1995, the phaseout limit is $26,676 for taxpayers with more than one qualifying child, $24,388 for taxpayers with one qualifying child, and $9,234 for taxpayers with no qualifying children.

Reasons for Change

The Committee believes that the individual income tax structure does not reduce tax liability by enough to reflect a family's reduced ability to pay taxes as family size increases. In part, this is because over the last 50 years the value of the dependent personal exemption has declined in real terms by over one-third. The Committee believes that a tax credit for families with dependent children will reduce the individual income tax burden of those families, will better recognize the financial responsibilities of raising dependent children, and will promote family values.

Explanation of Provision

The bill provides taxpayers with a maximum credit against income tax liability of $500 for each qualifying child.

The credit is phased out ratably for taxpayers with AGI over $200,000, and is fully phased out at AGI of $250,000. For purposes of the AGI phaseout, the taxpayer's AGI is increased by the amount otherwise excluded from gross income under Code section 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively). In calendar years beginning after 1996, the maximum credit amount ($500) and the beginning point of the phaseout range ($200,000) are indexed annually for inflation, with rounding to the nearest multiple of $50. The size of the phaseout range will change as needed so as to remain 100 times the maximum amount of the credit per child.

To be a qualifying child, an individual has to satisfy a relationship test, a dependency test, and an age test. An individual satisfies the relationship test if the individual is a son or daughter of the taxpayer, a descendant of a son or daughter of the taxpayer, a stepson or stepdaughter of the taxpayer, or an adopted child of the taxpayer. An adopted child includes a child who is legally adopted or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer. A foster child also satisfies the relationship test if, for the taxpayer's entire taxable year, the foster child (1) is a member of the taxpayer's household and (2) has as his principal place of abode the home of the taxpayer.

An individual satisfies the dependency test if the individual is a dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency deduction. For this purpose, the term "dependent" does not include an individual who is a resident of a country contiguous to the United States unless (1) that individual is an adopted child of a taxpayer who is a U.S. citizen or national and (2) for the taxpayer's entire taxable year, the individual is a member of the taxpayer's household and has as his principal place of abode the home of the taxpayer.

An individual satisfies the age test if the individual has not attained the age of 18 as of the close of the calendar year in which the taxable year of the taxpayer begins.

The bill provides that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from their spouse for the last six months of the taxable year and the individual claiming the credit (1) maintains as his or her home a household for the qualifying child for more than one-half of the taxable year and (2) furnishes over one-half of the cost of maintaining that household in that taxable year. An individual legally separated from his spouse under a decree of divorce or separate maintenance is not considered married for purposes of this provision.

Except in the case of a taxable year closed by reason of the taxpayer's death, no credit is allowable in the case of a taxable year covering a period of less than 12 months.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

B. Credit to Reduce the Marriage Penalty (sec. 102 of the bill and new sec. 24 of the Code)

Present Law

A married couple generally is treated as one tax unit that must pay tax on the unit's total taxable income. Although married couples may elect to file separate returns, the rate schedules and provisions are structured so that filing separate returns usually results in a higher tax than filing joint returns. Other rate schedules apply to single persons and to single heads of household.

A "marriage penalty" exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). A "marriage bonus" exists when the sum of the tax liabilities of the individuals is greater than their combined tax liability under a joint return.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose earnings are split more evenly than 70–30 suffer a marriage penalty. Married couples whose earnings are largely attributable to one spouse generally receive a marriage bonus.

Under present law, the size of the standard deduction and the bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and bracket breakpoints for single filers are roughly 60 percent of those for joint filers. The standard deduction and bracket breakpoints for head of household filers are about 83 percent of those for joint filers. With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals. Furthermore, because of the way the bracket breakpoints are structured, as joint filers they may have some of their taxable income pushed into a higher marginal tax bracket than when they were not married.

The rate changes in the Revenue Reconciliation Act of 1993 exacerbated the existing marriage penalty because the new bracket breakpoints did not provide the customary ratios across filing statuses. For the new 36-percent bracket, the breakpoint for single filers and for head of household filers are 82 percent and 91 percent, respectively, of the breakpoint for joint filers. For the 39.6-percent bracket that results from the "surtax," the bracket breakpoint is $250,000 regardless of filing status.

Reasons for Change

The Committee is concerned about the inequity of the marriage penalty and the potential work disincentive it causes. As the first step in response to these problems, the Committee believes it is appropriate to allow a credit to married couples who suffer a marriage penalty.

Any attempt to eliminate the marriage penalty involves the balancing of several competing principles, including equal tax treatment of married couples with equal incomes and the determination of equitable relative tax burdens of single individuals and married couples with equal incomes. The Committee believes that relief from the marriage penalty is needed because marriage penalties in the tax laws undermine respect for the family and may discourage family formation.

Allowing married couples to file individual returns according to the rates applicable to single individuals ("optional separate filing") would be very complex because of the necessity for rules to allocate income, deductions, and dependent exemptions between the spouses. With optional separate filing, many married couples would be burdened by having to compute tax liability under both options (jointly and separately) in order to determine which option minimizes tax liability. Furthermore, optional separate filing would provide tax reductions with respect to all types of income received by married couples, while the Committee believes that relief should be targeted to wages and salaries received by two-earner married couples.

To avoid these difficulties, the Committee believes it is appropriate to provide relief that can be determined by reference to a table in the tax information materials. The relief is designed to be directed only to those married couples who suffer a marriage penalty through the earnings of both spouses. Consequently, married couples whose distribution of earned income between the spouses currently creates a marriage bonus would not qualify for the credit.

Explanation of Provision

Under the bill, married couples who file a joint return may be eligible for a credit against their income tax liability. The amount of the credit is determined based on the earned income of each of the spouses. The Secretary of the Treasury is directed to issue tables calculating the marriage penalty credit applicable for married taxpayers based on the qualified earned income of each of the spouses.

Taxpayers may not claim a credit if they claim an exclusion from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U. S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively).

The amount of the credit is based on the hypothetical tax liabilities that would result if the individual income tax rates applicable to single filers were applied to each spouse's qualified earned income, allowing for one personal exemption and the standard deduction allowed for single filers. The sum of those hypothetical tax liabilities is compared to the hypothetical tax liability that would result if the individual income tax rates applicable to married couples filing joint returns were applied to the aggregate qualified earned income of the spouses, allowing for two personal exemptions and the standard deduction allowed for joint filers.

If the hypothetical tax liability of the married couple exceeds the sum of the hypothetical tax liabilities of the individual spouses, the married couple is allowed an income tax credit equal to the lesser of that excess or $145, with amounts less than the maximum credit rounded to the nearest multiple of $25. If the hypothetical tax liability of the married couple is less than or equal to the sum of the hypothetical tax liabilities of the individual spouses, the married couple is not allowed the credit.

In general, qualified earned income is earned income within the meaning of Code sections 911(d)(2) (relating to wages, salaries, professional fees, and other amounts received as compensation for personal services) or 401(c)(2)(C) (relating to dispositions of certain property created by the personal efforts of the taxpayer) less specified deductions allowable under section 62 that are properly allocable to such earned income. Under the bill, qualified earned income does not include any amount that is not includible in gross income, because untaxed income does not give rise to a marriage penalty. Wages exempt from certain social security taxes because an individual is in the employ of his or her spouse also are excluded from qualified earned income to prevent shifting of income between the spouses in a way that inaccurately reflects the earned income of each spouse. In addition, the qualified earned income of each spouse is computed without regard to any community property laws; that is, earned income is attributed to the spouse who renders the services for which the earned income is received.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

C. American Dream Savings Accounts and Deductible Spousal IRAs (secs. 103 and 104 of the bill and sec. 408 and new sec. 408A of the Code)

Present Law

Under present law, an individual may make deductible contributions to an individual retirement arrangement (IRA) up to the lesser of $2,000 or the individual's compensation if the individual (and, if married, the individual's spouse) is not an active participant in an employer-sponsored retirement plan. In addition, the $2,000 limit is increased to $2,250 in the case of a married taxpayer who files a joint return and makes contributions to an IRA for the benefit of his or her spouse, if the spouse has no compensation or elects to be treated as having no compensation. The $2,250 contribution can be divided in any manner between IRAs for each spouse, except that the maximum contribution to an IRA on behalf of one individual cannot exceed $2,000.

If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit (and the $2,250 spousal IRA deduction limit) is phased out over certain levels of adjusted gross income (AGI). The limit is phased out between $40,000 and $50,000 of AGI for married taxpayers, and between $25,000 and $35,000 of AGI for single taxpayers. An individual may make nondeductible IRA contributions to the extent the individual is not permitted to make deductible IRA contributions. Contributions cannot be made to an IRA after age 70½.

The amounts held in an IRA, including earnings on contributions, generally are not subject to tax until withdrawn. Amounts withdrawn prior to attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death, disability, or is made in the form of certain periodic payments. A similar early withdrawal tax applies to distributions from tax-qualified pension plans, with an additional exception for distributions used to pay medical expenses that exceed 7.5 percent of AGI. This exception for distributions to pay extraordinary medical expenses does not apply to withdrawals from IRAs.

In general, distributions from an IRA are required to begin at age 70½. An excise tax is imposed if the minimum required distributions are not made. Distributions to the beneficiary of an IRA are generally required to begin within 5 years of the death of the IRA owner, unless the beneficiary is the surviving spouse. Similar rules apply to distributions from tax-qualified pension plans.

Present law imposes a 15-percent excise tax on excess distributions with respect to an individual during any calendar year from qualified retirement plans, tax-sheltered annuities, and IRAs. The purpose of the tax is to limit the total amount that can be accumulated on behalf of a particular individual on a tax-favored basis. In general, excess distributions are defined as the aggregate amount of retirement distributions (i.e., payments from applicable retirement plans) made with respect to an individual during any calendar year to the extent such amounts exceed $150,000 (for 1995). The dollar limit is indexed for inflation. Special rules apply in the case of lump-sum distributions and post-death distributions.

Reasons for Change

The Committee is concerned about the national savings rate, and believes that individuals should be encouraged to save. The Committee believes that the ability to make deductible contributions to an IRA is a significant savings incentive. However, this incentive is not available to all taxpayers under present law. Further, the present-law income thresholds for IRA deductions are not indexed for inflation so that fewer Americans will be eligible to make a deductible IRA contribution each year, and the amount of the maximum contribution is declining in real terms over time.

The Committee believes it is appropriate to encourage individual saving and that some individuals would be more likely to save if funds set aside in a tax-favored account could be withdrawn without tax after a reasonable holding period. Some taxpayers may find such a vehicle more suitable for their savings needs.

The Committee believes that providing an incentive to save for certain special purposes is appropriate. The Committee believes that many Americans may have difficulty saving enough to ensure that their children will be able to afford a college education or to purchase a home. The ability to obtain a college education is an important factor in ensuring that the United States remains competitive with other nations. Home ownership is a fundamental part of the American dream. Large medical expenses can often deplete personal savings, as can the need to care for chronically ill individuals. Thus, the Committee believes that withdrawals from the new savings vehicle for first-time home purchase, education expenses, medical expenses, and long-term care premiums should be penalty-free.

Finally, the Committee believes that the present-law rules relating to deductible IRAs penalize American homemakers. The Committee believes that IRA contributions should be permitted for both spouses even though only one spouse works.

Explanation of Provision

Tax-free nondeductible IRAs

In general

The bill replaces present-law nondeductible IRAs with new American Dream Savings accounts (''ADS accounts'') to which individuals can make nondeductible contributions. Contributions to an ADS account are in addition to any contributions that can be made to a deductible IRA under the present-law rules. In general, an ADS account is an IRA which is designated at the time of establishment as an ADS account in the manner prescribed by the Secretary. Qualified distributions from an ADS account are not includible in income.

Contributions

The maximum annual contribution that could be made to an ADS account is the lesser of $2,000 or the individual's compensation for the year. In the case of a married couple, the aggregate compensation of the couple is taken into account in determining the maximum permitted contribution. Thus, for example, in 1996 each spouse in a married couple could make an ADS contribution of $2,000 (for a total contribution by the couple of $4,000), provided the couple has at least $4,000 in compensation. The $2,000 contribution limit is adjusted annually for inflation beginning after 1996. Inflation adjustments are rounded to the nearest $50.

Contributions to an ADS account can be made even after the individual for whom the account is maintained has attained age 70½.

Taxation of distributions

Qualified distributions from an ADS account are not includible in gross income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that is made after the 5-taxable year period[3] beginning with the first taxable

[3] In the case of rollover contributions that are not from another ADS account, the 5-year holding period begins on the date on which the rollover was made. As is the case with IRAs generally, contributions to an ADS account can be made for a year by the due date for the individual's tax return for the year (determined without regard to extensions). The 5-year holding period begins to run from the taxable year in which the individual is deemed to make the contribution.

year in which the individual made a contribution to an ADS account, and (2) which is (a) made on or after the date on which the individual attains age 59½, (b) made to a beneficiary (or to the individual's estate) on or after the death of the individual, (c) attributable to the individual's being disabled, or (d) a qualified special purpose distribution.

Qualified special purpose distributions (whether or not qualified distributions) are not subject to the 10-percent tax on early withdrawals. Distributions from an ADS account other than qualified distributions or qualified special purpose distributions are includible in gross income to the extent attributable to earnings and subject to the 10-percent tax on early withdrawals.

In general, qualified special purpose distributions are distributions for: the purchase or acquisition of a principal residence of a first-time homebuyer; qualified higher education expenses; for medical expenses of the taxpayer or the taxpayer's spouse and dependents; or long-term care insurance premiums treated as medical expenses under the long-term care provisions of the bill.

First-time homebuyers are individuals who did not own an interest in a principal residence during the 3 years prior to the purchase of a home. In order to qualify as a first-time homebuyer distribution, the distribution must be used within 60 days to pay the costs of acquiring, contracting, or reconstructing a residence. If there is a delay in acquisition, construction, or reconstruction, the distribution can be redeposited in an ADS account within 120 days without imposition of tax.

Qualified higher education expenses are tuition, fees, books, supplies and equipment required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a child or grandchild of the taxpayer at an eligible educational institution (defined as under sec. 135). The amount of qualified higher education expenses is reduced by any amount excludable from income under the present-law rules relating to education savings bonds (sec. 135).

The pre-death minimum distribution rules that apply to IRAs do not apply to ADS accounts, and amounts in ADS accounts are not taken into account for purposes of the excise tax on excess distributions.

Rollovers

Distributions from ADS accounts can be rolled over tax free to another ADS account.

In addition, amounts withdrawn from an IRA can be rolled over to an ADS account after December 31, 1995, and before January 1, 1998. The amount otherwise includible in gross income due to the IRA distribution is includible in gross income ratably over the 4-taxable year period beginning with the taxable year in which the distribution is made. The early withdrawal tax does not apply to such rollovers.

Deductible contributions to spousal IRAs

The bill modifies the present-law rules relating to deductible IRAs by permitting deductible IRA contributions of up to $2,000 to be made for each spouse if the combined compensation of both spouses is at least equal to the contributed amount. The bill does not otherwise modify the rules relating to deductible IRAs. Thus, the present-law limitations on deductible contributions by an individual who is an active participant in an employer-sponsored retirement plan (or whose spouse is an active participant) continue to apply.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

TITLE II. SENIOR CITIZENS' EQUITY

A. Repeal of Increase in Income Tax on Social Security Benefits (sec. 201 of the bill and secs. 86(a) and 871(a)(3) of the Code)

Present Law

In general

Under present law, taxpayers receiving Social Security and Railroad Retirement Tier 1 benefits are not required to include any such benefits in gross income if their "provisional income" does not exceed $25,000 in the case of unmarried taxpayers or $32,000 in the case of married taxpayer's filing joint returns. For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income plus tax-exempt interest plus certain foreign source income plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit.

Certain taxpayers with provisional income in excess of those thresholds are required to include in gross income up to 50 percent of their Social Security or Railroad Retirement Tier 1 benefit. Under a provision added by the Revenue Reconciliation Act of 1993 ("1993 Act"), taxpayers with provisional income in excess of a second-tier threshold ($34,000 in the case of unmarried taxpayers or $44,000 in the case of married taxpayers filing joint returns) are required to include in gross income up to 85 percent of their Social Security or Railroad Retirement Tier 1 benefit.

If the taxpayer's provisional income exceeds the lower threshold but does not exceed the second-tier threshold, then the amount of the inclusion is the lesser of (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the lower threshold.

If the amount of provisional income exceeds the second-tier threshold, then the amount of the inclusion is the lesser of:

(1) 85 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or

(2) the sum of:

(a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold,

plus,

(b) the smaller of (i) the amount of benefits that would have been included if the 50-percent inclusion rule (the rule in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and lower threshold.

Treatment of nonresident alien individuals

If a nonresident alien individual is engaged in a trade or business within the United States during the taxable year, the individual is subject to U.S. tax at the normal graduated rates on net taxable income that is effectively connected with the conduct of the U.S. trade or business. U.S. source fixed or determinable annual or periodic income of a nonresident alien individual (for example, salary, wages, annuities, compensation, remuneration, and emoluments) that is not effectively connected with the conduct of a U.S. trade or business generally is subject to tax at a rate of 30 percent of the gross amount paid. This latter tax generally is collected by means of withholding (hence this tax is often called a "withholding tax"). Withholding taxes are often reduced or eliminated in the case of payments to residents of countries with which the United States has an income tax treaty.

For purposes of taxing the income of nonresident alien individuals, the income thresholds for including Social Security and Railroad Retirement Tier 1 benefits do not apply. Instead, a fixed percentage of any such benefit is included in gross income. Until January 1, 1995, that percentage was 50 percent. Thus, prior to 1995, a nonresident alien individual typically was subject to U.S. withholding tax at an effective rate of 15 percent on the gross amount of U.S. Social Security benefits. This tax was reduced or eliminated under some treaties. Although the Omnibus Budget Reconciliation Act of 1993 increased the inclusion of benefits in some cases for taxpayers other than nonresident aliens (to up to 85 percent of the benefits), it did not amend the rule that a nonresident alien individual was required to include 50 percent (and only 50 percent) of these benefits in gross income.

The implementing legislation for the General Agreement on Tariffs and Trade (P. L. 103–465) increased from 50 percent to 85 percent the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual, effective for benefits paid after December 31, 1994, in taxable years ending after such date. Thus, a nonresident alien individual may be subject to U.S. withholding tax at an effective rate of 25. 5 percent on the gross amount of U.S. Social Security or Railroad Retirement Tier 1 benefits.

Trust funds

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the 1993 Act increase in the portion of benefits included in gross income are credited quarterly to the Medicare Hospital Insurance (HI) Trust Fund. The remainder of the proceeds from the income taxation of Social Security and Railroad Retirement Tier 1 benefits are credited quarterly to the Old-Age and Survivors Insurance Trust Fund, the Disability Insurance Trust Fund, or the Social Security Equivalent Benefit Account (of the Railroad Retirement system), as appropriate.

Congress designated the revenues attributable to the 1993 Act increase in the portion of Social Security benefits included in gross income as HI trust fund revenues to clarify the differing nature of these tax revenues from Old-Age and Survivors and Disability Insurance (OASDI) taxes as contemplated at the time of enactment of the Budget Enforcement Act of 1990. For purposes of the fiscal year 1994 President's Budget and Budget Resolution, and the 1993 Budget Reconciliation Act, revenues from the increased taxation of Social Security benefits were not intended to be considered as OASDI taxes for Budget Act enforcement purposes, including Social Security firewall provisions. These revenues were considered on budget, and treated as an item on the PAYGO scorecard, as were the payment and receipt of the allocation of these revenues to the Medicare Hospital Insurance Trust Fund.

Reasons for Change

The Committee believes that the provision in the 1993 Act that increased inclusion of social security benefits resulted in burdensome taxation of certain senior citizens. Furthermore, the Committee is concerned that for future retirees, the inclusion in gross income of up to 85 percent of social security benefits will result in tax treatment of those benefits that is less favorable than the tax treatment of private pension benefits. For these reasons, the Committee believes that repeal of the 1993 Act provision is necessary to restore equity.

Explanation of Provision

In general

The bill phases in a repeal of the higher rate of income inclusion for taxpayers with provisional incomes in excess of the second-tier threshold.

For taxable years beginning in calendar years 1996 through 1999, if the amount of provisional income exceeds the second-tier threshold, then the amount of the inclusion is calculated as under present law, except that the following rates are substituted for 85 percent:

For taxable years beginning in calendar year—	*The percentage is—*
1996	75 percent
1997	65 percent
1998	60 percent
1999	55 percent.

For taxable years beginning after December 31, 1999, Social Security and Railroad Retirement Tier 1 benefits will be treated as under the law prior to 1994: if the amount of provisional income exceeds $25,000 in the case of unmarried taxpayers or $32,000 in the case of married taxpayers filing joint returns, then the amount of the inclusion is the lesser of (1) 50 percent of the taxpayers Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayers provisional income over the threshold.

Treatment of nonresident alien individuals

The bill phases in a reduction in the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual. The inclusion percentage for any taxable year beginning in calendar years 1996 through 1999 is as given in the table above. For taxable years beginning after December 31, 1999, the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual will be 50 percent.

Trust funds

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the increased portion of benefits included in gross income under the 1993 Act (as phased out under the provision) will be credited to the Old-Age and Survivors and Disability Insurance Trust Funds.

Effective Date

In general, the provision is effective for taxable years beginning after December 31, 1995. The provision crediting revenues to the Old-Age and Survivors and Disability Insurance Trust Funds applies to tax liabilities for taxable years beginning after December 31, 1995.

B. Treatment of Long-Term Care Insurance and Services (secs. 211–214 and 231–232 of the bill and secs. 91, 106, 125, 137, 213, 807(d)(3), 1035, 4980B, and 6050Q of the Code)

Present Law

In general

Present law generally does not provide explicit rules relating to the tax treatment of long-term care insurance contracts or long-term care services. Thus, the treatment of long-term care contracts and services is unclear. Present law does provide rules relating to medical expenses and accident or health insurance.

Itemized deduction for medical expenses

In determining taxable income for Federal income tax purposes, a taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during the taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer, to the extent that such expenses exceed 7.5 percent of the adjusted gross income of the taxpayer for such year (sec. 213). For this purpose, expenses paid for medical care generally are defined as amounts paid: (1) for the diagnosis, cure, mitigation, treatment, or prevention of disease (including prescription medicines or drugs and insulin), or for the purpose of affecting any structure or function of the body (other than cosmetic surgery not related to disease, deformity, or accident); (2) for transportation primarily for, and essential to, medical care referred to in (1); or (3) for insurance (including Part B Medicare premiums) covering medical care referred to in (1) and (2).

Exclusion for amounts received under accident or health insurance

Amounts received by a taxpayer under accident or health insurance for personal injuries or sickness generally are excluded from gross income to the extent that the amounts received are not attributable to medical expenses that were allowed as a deduction for a prior taxable year (sec. 104).

Treatment of accident or health plans maintained by employers

Contributions of an employer to an accident or health plan that provides compensation (through insurance or otherwise) to an employee for personal injuries or sickness of the employee, the employee's spouse, or a dependent of the employee, are excluded from the gross income of the employee (sec. 106). In addition, amounts received by an employee under such a plan generally are excluded from gross income to the extent that the amounts received are paid, directly or indirectly, to reimburse the employee for expenses for the medical care of the employee, the employee's spouse, or a dependent of the employee (sec. 105). For this purpose, expenses incurred for medical care are defined in the same manner as under the rules regarding the deduction for medical expenses.

A cafeteria plan is an employer-sponsored arrangement under which employees can elect among cash and certain employer-provided qualified benefits. No amount is included in the gross income of a participant in a cafeteria plan merely because the participant has the opportunity to make such an election (sec. 125). Employer-provided accident or health coverage is one of the benefits that may be offered under a cafeteria plan.

A flexible spending arrangement (FSA) is an arrangement under which an employee is reimbursed for medical expenses or other nontaxable employer-provided benefits, such as dependent care, and under which the maximum amount of reimbursement that is reasonably available to a participant for a period of coverage is not substantially in excess of the total premium (including both employee-paid and employer-paid portions of the premium) for such participant's coverage. Under proposed Treasury regulations, a maximum amount of reimbursement is not substantially in excess of the total premium if such maximum amount is less than 500 percent of the premium. An FSA may be part of a cafeteria plan or provided by an employer outside a cafeteria plan. FSAs are commonly used to reimburse employees for medical expenses not covered by insurance. If certain requirements are satisfied,[4] amounts reimbursed for nontaxable benefits from an FSA are excludable from income.

Health care continuation rules

The health care continuation rules require that an employer must provide qualified beneficiaries the opportunity to continue to participate for a specified period in the employer's health plan after the occurrence of certain events (such as termination of employment) that would have terminated such participation (sec. 4980B). Individuals electing continuation coverage can be required to pay for such coverage.

---

[4] These requirements include a requirement that a health FSA can only provide reimbursement for medical expenses (as defined in sec. 213) and cannot provide reimbursement for premium payments for other health coverage and that the maximum amount of reimbursement under a health FSA must be available at all times during the period of coverage.

Life insurance company reserve rules

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net decreases in reserves (sec. 807(a) and (b)). Present law prescribes a tax reserve method based on the nature of the contract. For noncancellable accident and health insurance contracts, the prescribed method is a two-year full preliminary term method (sec. 807(d)(3)(A)(iii)). Long-term care insurance reserves are treated like noncancellable accident and health insurance for this purpose and, therefore, are determined under the two-year full preliminary term method. In no event is the tax reserve for any contract as of any time permitted to exceed the amount which would be taken into account in determining statutory reserves as set forth on the annual statement (sec 807(d)(1)).

The amount of any adjustment, whether an increase or a reduction in income, that is attributable to a change in the basis for determining reserves (or for determining any other item referred to in sec. 807(c)) is generally spread over a 10-year period (sec. 807(f)).

Reasons for Change

Providing an incentive for individuals to take financial responsibility for their long-term health care is an important element of the Contract With America. The bill therefore provides generally for the treatment of long-term care services and eligible long-term care premiums as medical expenses for purposes of the itemized deduction for medical expenses, and the exclusion (subject to dollar limits) from income of certain amounts paid under long-term care insurance contracts and long-term care riders to life insurance contracts that meet the bill's requirements. In order further to encourage taxpayers to direct resources to financing their long-term health care, the bill also permits tax-free exchanges of life insurance, annuity and endowment contracts for long-term care insurance contracts, and permits withdrawals, free from the early withdrawal tax or other income tax, of elective deferral amounts under certain pension plans to the extent of premiums paid for any long-term care insurance contract during the year.

Under the National Association of Insurance Commissioners (NAIC) Long-Term Care Insurance Model Act and Regulations, which have been adopted by some States, long-term care insurance reserves are calculated under a one-year full preliminary term method, while a two-year full preliminary term method is required for Federal income tax purposes. Because of this inconsistency, in some cases life insurance companies are required to establish reserves for long-term care insurance contracts earlier for State regulatory purposes than they do for Federal tax purposes. In addition, some life insurance companies have voluntarily complied with the NAIC model act and regulations. The bill therefore modifies the reserve method applicable to long-term care insurance contracts under the life insurance company tax rules so that this disparity is eliminated with respect to contracts issued after the effective date.

Explanation of Provision

Tax treatment and definition of long-term care insurance contracts and qualified long-term care services

In general

Under the bill, a long-term care insurance contract is accorded the following tax treatment. A long-term care insurance contract generally is treated as an accident and health insurance contract.[5] Amounts (other than policyholder dividends or premium refunds) received under a long-term care insurance contract generally are excludable as amounts received for personal injuries and sickness (subject to a cap of $200 per day, or $73,000 annually). A plan of an employer providing coverage under a long-term care insurance contract generally is treated as an accident and health plan; however, coverage under a long-term care insurance contract is not excludable by an employee if provided through a cafeteria plan; similarly, expenses for long-term care services cannot be reimbursed under an FSA.[6]

Within certain limits, premiums for long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses.[7] In addition, expenses for qualified long-term care services are treated as medical expenses for purposes of the itemized deduction.

Definition of long-term care insurance contract

A long-term care insurance contract is defined as any insurance contract that provides only coverage of qualified long-term care services and that meets other requirements. The other requirements are that (1) the contract is guaranteed renewable, (2) the contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged or borrowed, (3) refunds (other than refunds on the death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits, and (4) the contract generally does not pay or reimburse expenses reimbursable under Medicare (except where Medicare is a secondary payor, or the contract makes per diem or other periodic payments without regard to expenses).[8]

A contract does not fail to be treated as a long-term care insurance contract solely because it provides for payments on a per diem

[5] Prior to December 31, 1993, a self-employed individual was entitled to deduct up to 25 percent of the health insurance expenses for the individual and his or her spouse and dependents. The bill treats long-term care insurance as health insurance. Thus, if the 25-percent deduction is extended, it would apply to long-term care insurance premiums under the bill. H.R. 831 as passed by the House on February 21, 1995, would retroactively and permanently extend the 25-percent deduction.

[6] The bill does not otherwise modify the requirements relating to FSAs. An FSA is defined (as under proposed regulations) as a benefit program providing employees with coverage under which specified incurred expenses may be reimbursed (subject to maximums and other reasonable conditions), and the maximum amount of reimbursement that is reasonably available to a participant is less than 500 percent of the value of the coverage.

[7] Similarly, within certain limits, in the case of a rider to a life insurance contract, charges against the life insurance contract's cash surrender value that are includible in income are treated as medical expenses (provided the rider constitutes a long-term care insurance contract).

[8] The bill provides that no provision of law shall be construed or applied so as to prohibit the offering of a long-term care insurance contract on the basis that the contract coordinates its benefits with those provided under Medicare. Thus, long-term care insurance contracts are not subject to the rules requiring duplication of Medicare benefits.

or other periodic basis without regard to expenses during the period.

Definition of qualified long-term care services

Qualified long-term care services means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating and rehabilitative services, and maintenance or personal care services that are required by a chronically ill individual and that are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

A chronically ill individual is one who has been certified within the previous 12 months by a licensed health care practitioner as being unable to perform (without substantial assistance) at least 2 activities of daily living for at least 90 days [9] due to a loss of functional capacity or cognitive impairment, or having a similar level of disability as determined by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services. Activities of daily living are eating, toileting, transferring, bathing, dressing and continence.[10]

A licensed health care practitioner is a physician (as defined in sec. 1861(r)(l) of the Social Security Act) and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary of the Treasury.

Itemized deduction for medical expenses

Unreimbursed expenses for qualified long-term care services provided to the taxpayer or the taxpayer's spouse or dependent are treated as medical expenses for purposes of the itemized deduction for medical expenses (subject to the present-law floor of 7.5 percent of adjusted gross income). For this purpose, amounts received under a long-term care insurance contract (regardless of whether the contract reimburses expenses or pays benefits on a per diem or other basis) are treated as reimbursement for expenses actually incurred for medical care.

For purposes of the deduction for medical expenses, qualified long-term care services do not include services provided to an individual by a relative (directly, or through a partnership, corporation, or other entity), unless the relative is a licensed professional with respect to such services, or by a related corporation (within the meaning of Code section 267(b) or 707(b)).[11]

Long-term care insurance premiums that do not exceed specified dollar limits are treated as medical expenses for purposes of the itemized deduction for medical expenses. The limits are as follows:

[9] The 90-day period is not a waiting period. Thus, an individual can be certified as chronically ill if the licensed health care practitioner certifies that the individual will be unable to perform at least 2 activities of daily living for at least 90 days.

[10] Nothing in the bill requires the contract to take into account all of the activities of daily living. For example, a contract could require that an individual be unable to perform (without substantial assistance) 2 out of any 5 such activities, or for another example, 3 out of the 6 activities.

[11] The rule limiting such services provided by a relative or a related corporation does not apply for purposes of the exclusion for amounts received under a long-term care insurance contract, whether the contract is employer-provided or purchased by an individual. The limitation is unnecessary in such cases because it is anticipated that the insurer will monitor reimbursements to limit opportunities for fraud in connection with the performance of services by the taxpayer's relative or a related corporation.

In the case of an individual with an attained age before the close of the taxable year of:	*The limitation on premiums paid for such taxable years is*:
Not more than 40	$200
More than 40 but not more than 50	375
More than 50 but not more than 60	750
More than 60 but not more than 70	2,000
More than 70	2,500

For taxable years beginning after 1996, these dollar limits are indexed for increases in the medical care component of the consumer price index. The Secretary of the Treasury, in consultation with the Secretary of Health and Human Services, is directed to develop a more appropriate index to be applied in lieu of the foregoing. Such an alternative might appropriately be based on increases in skilled nursing facility and home health care costs. It is intended that the Treasury Secretary annually publish the indexed amount of the limits as early in the year as they can be calculated.

Long-term care riders on life insurance contracts

In the case of long-term care insurance coverage provided by a rider on a life insurance contract, the requirements applicable to long-term care insurance contracts apply as if the portion of the contract providing such coverage were a separate contract. The term ''portion'' means only the terms and benefits that are in addition to the terms and benefits under the life insurance contract without regard to long-term care coverage. The guideline premium limitation applicable under section 7702(c)(2) is increased by the sum of charges (but not premium payments) against the life insurance contract's cash surrender value, the imposition of which reduces premiums paid for the contract (within the meaning of sec. 7702(f)(1)). In addition, it is anticipated that Treasury regulations will provide for appropriate reduction in premiums paid (within the meaning of sec. 7702(f)(1)) to reflect the payment of benefits under the rider that reduce the cash surrender value of the life insurance contract. A similar rule should apply in the case of a contract governed by section 101(f) and in the case of the payments under a rider that are excludable under section 101(g) of the Code (as added by this bill).

Life insurance company reserves

In determining reserves for insurance company tax purposes, the bill provides that the Federal income tax reserve method applicable for a long-term care insurance contract issued after December 31, 1995, is the method prescribed by the National Association of Insurance Commissioners (or, if no reserve method has been so prescribed, a method consistent with the tax reserve method for life insurance, annuity or noncancellable accident and health insurance contracts, whichever is most appropriate). The method currently prescribed by the NAIC for long-term care insurance contracts is the one-year full preliminary term method. As under present law, however, in no event may the tax reserve for a contract as of any time exceed the amount which would be taken into account with respect to the contract as of such time in determining statutory reserves.

Health care continuation rules

The health care continuation rules do not apply to coverage under a long-term care insurance contract.

Exchanges of life insurance and other contracts for long-term care insurance contracts

The exchange of a life insurance contract or an endowment or annuity contract for a qualified long-term care insurance contract is not taxable under the bill.

Certain distributions from IRAs and retirement plans for long-term care insurance excludable from income

The bill excludes from gross income distributions from individual retirement arrangements (IRAs) and distributions attributable to elective deferrals to qualified cash or deferred arrangements (sec. 401(k) plans), tax-sheltered annuities (sec. 403(b) plans), nonqualified deferred compensation plans of governmental or tax-exempt employers (sec. 457 plans), and section 501(c)(18) plans used to pay premiums for long-term care insurance for the individual or the individual's spouse. Such distributions are also not subject to the 10-percent tax on early withdrawals. A plan will not fail to meet the Internal Revenue Code requirements applicable to such plan merely because it permits such distributions.

Inclusion of excess long-term care benefits

In general, the bill provides that the maximum annual amount of long-term care benefits excludable from income with respect to an insured who is chronically ill (not including amounts received by reason of the individual being terminally ill)[12] cannot exceed the equivalent of $200 per day for each day the individual is chronically ill. Thus, the maximum annual exclusion for long-term care benefits with respect to any chronically ill individual (not including amounts received by reason of the individual being terminally ill) is $73,000 (for 1996). Long-term care benefits for this purpose include payments and other benefits received under a long-term care insurance contract (to the extent otherwise excludable under section 7702B(b) as added by the bill) and payments that are otherwise excludable under the provision of the bill related to accelerated death benefits and viatical settlements with respect to persons who are chronically ill (sec. 101(g) (as added by the bill). If the insured is not the same as the holder of the contract, the insured may assign some or all of this limit to the contract holder at the time and manner prescribed by the Secretary.

This $200 per day limit is indexed for inflation after 1996 for increases in the medical care component of the consumer price index. The Treasury Secretary, in consultation with the Secretary of Health and Human Services, is directed to develop a more appropriate index, to be applied in lieu of the foregoing. Such an alternative might appropriately be based on increases in skilled nursing facility and home health care costs. It is intended that the Treas-

[12] Terminally ill is defined as under the provision of the bill relating to accelerated death benefits. In general, under that provision, an individual is considered to be terminally ill if he or she is certified as having an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of the certification.

ury Secretary annually publish the indexed amount of the limit as early in the year as it can be calculated.

A payor of long-term care benefits (as defined above) is required to report to the IRS the aggregate amount of such benefits paid to any individual during any calendar year, and the name, address and taxpayer identification number of such individual. A copy of the report must be provided to the payee by January 31 following the year of payment, showing the name of the payor and the aggregate amount of benefits paid to the individual during the calendar year. Failure to file the report or provide the copy to the payee is subject to the generally applicable penalties for failure to file similar information reports.

Effective Date

The provisions defining long-term care insurance contracts and qualified long-term care services apply to contracts issued after December 31, 1995. Any contract issued before January 1, 1996, that met the long-term care insurance requirements in the State in which the policy was sitused at the time it was issued is treated as a long-term care insurance contract, and services provided under or reimbursed by the contract are treated as qualified long-term care services.

A contract providing for long-term care insurance may be exchanged for a long-term care insurance contract (or the former cancelled and the proceeds reinvested in the latter within 60 days) tax free between the date of enactment and January 1, 1996. Taxable gain would be recognized to the extent money or other property is received in the exchange.

The issuance or conformance of a rider to a life insurance contract providing long-term care insurance coverage is not treated as a modification or a material change for purposes of applying sections 101(f), 7702 and 7702A of the Code.

The provisions relating to (1) treatment as a medical expense of qualified long-term care insurance services and eligible long-term care premiums and (2) tax-free exchanges of life insurance, endowment and annuity contracts for long-term care insurance contracts, are effective for taxable years beginning after December 31, 1995.

The change in treatment of reserves for long-term care insurance contracts is effective for contracts issued after December 31, 1995. If, after that date, a company changes its tax reserve method for long-term care insurance contracts issued after that date, the amount of any adjustment arising from the change with respect to those contracts is spread over a 10-year period as provided in section 807(f).

The provision relating to certain distributions from IRAs and elective deferrals used to pay long-term care insurance premiums is effective for payments and distributions after December 31, 1995.

The provisions relating to the maximum exclusion for long-term care benefits and reporting are effective for taxable years beginning after December 31, 1995. Thus, the initial year in which reports will be filed with the IRS and copies provided to the payee will be 1997, with respect to long-term care benefits paid in 1996.

C. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts (secs. 221–222 and 231–232 of the bill and secs. 91, 101(g), 818(g), 6050Q, and 6724(d) of the Code)

Present Law

Treatment of amounts received under a life insurance contract

If a contract meets the definition of a life insurance contract, gross income does not include insurance proceeds that are paid pursuant to the contract by reason of the death of the insured (sec. 101(a)). In addition, the undistributed investment income ("inside buildup") earned on premiums credited under the contract is not subject to current taxation to the owner of the contract. The exclusion under section 101 applies regardless of whether the death benefits are paid as a lump sum or otherwise.

Amounts received under a life insurance contract (other than a modified endowment contract) prior to the death of the insured are includible in the gross income of the recipient to the extent that the amount received constitutes cash value in excess of the taxpayer's investment in the contract (generally, the investment in the contract is the aggregate amount of premiums paid less amounts previously received that were excluded from gross income).

If a contract fails to be treated as a life insurance contract under section 7702(a), inside buildup on the contract is generally subject to tax (sec. 7702(g)).

Requirements for a life insurance contract

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement (sec. 7702(a)). A contract satisfies the cash value accumulation test if the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

Proposed regulations on accelerated death benefits

The Treasury Department has issued proposed regulations [13] under which certain "qualified accelerated death benefits" paid by reason of the terminal illness of an insured would be treated as paid by reason of the death of the insured and therefore qualify for exclusion under section 101. In addition, the proposed regulations would permit an insurance contract that includes a qualified accelerated death benefit rider to qualify as a life insurance contract

[13] Prop. Treas. Reg. Secs. 1.101–8, 1.7702–0, 1.7702–2, and 1.7702A–1 (December 15, 1992).

under section 7702. Thus, the proposed regulations provide that including this benefit would not cause an insurance contract to fail to meet the definition of a life insurance contract.

Under the proposed regulations, a benefit would qualify as a qualified accelerated death benefit only if it meets three requirements. First, the accelerated death benefit can be payable only if the insured becomes terminally ill. Second, the amount of the benefit must equal or exceed the present value of the reduction in the death benefit otherwise payable.[14] Third, the cash surrender value and the death benefit payable under the policy must be reduced proportionately as a result of the accelerated death benefit.

For purposes of the proposed regulations, an insured would be treated as terminally ill if he or she has an illness that, despite appropriate medical care, the insurer reasonably expects to result in death within twelve months from the payment of the accelerated death benefit. The proposed regulations would not apply to viatical settlements.

Reasons for Change

The Committee wishes to extend the present-law rule permitting an exclusion from income for amounts paid under a life insurance contract by reason of the death of the insured to accelerated death benefits paid with respect to certain terminally ill and chronically ill insured individuals. In addition, in the case of a terminally ill or chronically ill insured individual, the Committee believes that this exclusion from income should be extended to certain sales or assignments of all or a portion of a life insurance contract to a viatical settlement provider. The Committee believes that a single set of rules should apply to benefits received with respect to a chronically ill individual. To provide parity in treatment, the same definition of a chronically ill individual applies for purposes of the rules under this provision and the rules governing long-term care insurance contracts. Further, the $200 per day ($73,000 annual) limit on excludability of benefits for chronically ill individuals applies in both situations as well.

Explanation of Provision

The bill provides an exclusion from gross income as an amount paid by reason of the death of an insured for (1) amounts received under a life insurance contract and (2) amounts received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured under the life insurance contract is either terminally ill or chronically ill.[15]

The provision does not apply in the case of an amount paid to any taxpayer other than the insured, if such taxpayer has an insur-

---

[14] For purposes of determining the present value under the proposed regulations, the maximum permissible discount rate would be the greater of (1) the applicable Federal rate that applies under the discounting rules for property and casualty insurance loss reserves, and (2) the interest rate applicable to policy loans under the contract. Also, the present value would be determined assuming that the death benefit would have been paid twelve months after payment of the accelerated death benefit.

[15] The exclusion for amounts received under a life insurance contract on the life of an insured who is chronically ill applies if the amount is received under a rider or other provision of the contract that is treated as a long-term care insurance contract under section 7702B (as added by the bill).

able interest by reason of the insured being a director, officer or employee of the taxpayer, or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

A terminally ill individual is defined as one who has been certified by a physician as having an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of certification. A physician is defined for this purpose in the same manner as under the long-term care insurance rules of the bill.[16]

A chronically ill individual is defined as under the long-term care provisions of the bill.[17] In the case of amounts received with respect to a chronically ill individual (but not amounts received by reason of the individual being terminally ill), the $200 per day ($73,000 annual) limitation on excludable benefits applies.[18] A payor of such an accelerated death benefit or a qualified viatical settlement provider making such a payment with respect to an individual who is chronically ill is required to report to the IRS the aggregate amount of such benefits paid to any individual during any calendar year, and the name, address and taxpayer identification number of such individual. A copy of the report must be provided to the payee by January 31 following the year of payment, showing the name of the payor and the aggregate amount of such benefits paid to the individual during the calendar year. Failure to file the report or provide the copy to the payee is subject to the generally applicable penalties for failure to file similar information reports.

A qualified viatical settlement provider is any person that regularly purchases or takes assignments of life insurance contracts on the lives of terminally ill or chronically ill individuals and either (1) is licensed for such purposes in the State in which the insured resides, or (2) if the person is not required to be licensed by that State, meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act issued by the National Association of Insurance Commissioners (relating to disclosure requirements and general rules for a viatical settlement contract).

For life insurance company tax purposes, the bill provides that a life insurance contract is treated as including a reference to a

---

[16] A physician is defined for these purposes as in section 1861(r)(1) of the Social Security Act, which provides that a physician means a doctor of medicine or osteopathy legally authorized to practice medicine and surgery by the State in which he performs such function or action (including a physician within the meaning of section 1101(a)(7) of that Act). Section 1101(a)(7) of that Act provides that the term physician includes osteopathic practitioners within the scope of their practice as defined by State law.

[17] Thus, a chronically ill individual is one who has been certified within the previous 12 months by a licensed health care practitioner as being unable to perform (without substantial assistance) at least 2 activities of daily living for at least 90 days due to a loss of functional capacity or cognitive impairment, or having a similar level of disability as determined by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services. Activities of daily living are eating, toileting, transferring, bathing, dressing and continence. Nothing in the bill requires the contract to take into account all of the activities of daily living.

[18] In general, the bill provides that the maximum annual amount of benefits excludable from income under sections 7702B(a)(2) or 101(g) (as added by this bill) with respect to an insured who is chronically ill (but not amounts received by reason of the insured being terminally ill) cannot exceed the equivalent of $200 per day for each day the individual is chronically ill. Thus, the maximum annual exclusion for long-term care benefits with respect to any chronically ill individual (but not amounts received by reason of the insured being terminally ill) is $73,000 (for 1996). If the insured is not the same as the holder of the contract, the insured may assign some or all of this limit to the contract holder at the time and manner prescribed by the Secretary.

qualified accelerated death benefit rider to a life insurance contract (except in the case of any rider that is treated as a long-term care insurance contract under section 7702B, as added by the bill). A qualified accelerated death benefit rider is any rider on a life insurance contract that provides only for payments of a type that are excludable under this provision.

Effective Date

The provision applies to amounts received after December 31, 1995. The provision treating a qualified accelerated death benefit rider as life insurance for life insurance company tax purposes takes effect on January 1, 1996. The issuance of a qualified accelerated death benefit rider to a life insurance contract, or the addition of any provision required to conform an accelerated death benefit rider to these provisions, is not treated as a modification or material change of the contract (and is not intended to affect the issue date of any contract under section 101(f)).

TITLE III. JOB CREATION AND WAGE ENHANCEMENT ACT

A. Capital Gains Provisions

1. 50-percent capital gains deduction for individuals (sec. 301 of the bill and new sec. 1202 of the Code)

Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, the net capital gain is taxed at the same rate as ordinary income, except that individuals are subject to a maximum marginal rate of 28 percent of the net capital gain. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method.

The Revenue Reconciliation Act of 1993 provided a 50-percent exclusion for gain from the sale of certain small business stock acquired at original issue and held for at least five years. One-half of the excluded amount is a minimum tax preference.

Prior to the enactment of the Tax Reform Act of 1986, individuals were allowed a deduction equal to 60 percent of net capital gain. The deduction resulted in a maximum effective tax rate of 20 percent on such gains.

Capital losses are generally deductible in full against capital gains. In addition, individuals may deduct capital losses against up to $3,000 of ordinary income in each year. Capital losses in excess of the amount deductible are carried forward indefinitely in the case of individuals, and generally carried back three years and forward five years in the case of corporations. Prior to the Tax Reform Act of 1986, individuals were required to use two dollars of long-term capital loss to offset each dollar of ordinary income.

Reasons for Change

The Committee believes it is important that tax policy be conducive to economic growth. Economic growth cannot occur without saving, investment, and the willingness of individuals to take risks and exploit new market opportunities. The greater the pool of savings, the greater the monies available for business investment in equipment and research. It is through such investment in equipment and new products and services that the United States economy can increase output and productivity. It is through increases in productivity that workers earn higher real wages. Hence, greater saving is necessary for all Americans to benefit through a higher standard of living.

The net personal saving rate in the United States averaged 4.8 percent of gross domestic product (GDP) in the 1980s, below the 5.5 percent rate of the 1970s, and far below the rates of Japan, Germany, Canada and other major trading partners. The net personal saving rate reported by the Department of Commerce for 1990 through 1992 averaged only 3.5 percent of GDP. The Committee believes such saving is inadequate to finance the investment that is needed to equip the country's businesses with the equipment and research dollars necessary to create the higher productivity that results in higher real wages for working Americans. A reduction in the taxation of capital gains increases the rate of return on household saving. Testimony by many economists before the Committee generally concluded that increasing the after-tax return to saving should increase the saving rate of American households.

American technological leadership has been enhanced by the willingness of individuals to take the risk of pursuing new businesses exploiting new technologies. Risk taking is stifled if the taxation of any resulting gain is high and the ability to claim losses is limited. The Committee believes it is important to encourage risk taking and believes a reduction in the taxation of capital gains will have that effect.

Reduction in the taxation of capital gains also should improve the efficiency of the capital markets. The taxation of capital gains upon realization encourages investors who have accrued past gains to keep their monies "locked in" to such investments even when better investment opportunities present themselves. All economists that testified before the Committee agreed that reducing the rate of taxation of capital gains would encourage investors to unlock many of these gains. This unlocking will permit more monies to flow to new, highly valued uses in the economy. When monies flow freely, the efficiency of the capital market is improved.

The unlocking effect also has the short-term and long-term effect of increasing revenues to the Federal Government. The current revenue estimating methods employed by the Congress account for this long-term behavioral response. Nevertheless, current Congressional estimates project that revenue losses to the Federal Government will arise from the reduction in the tax rate on capital gains beginning in fiscal year 1997. The Committee observes, however, that the conservative approach embodied in such estimates does not attempt to account for the potential for increased growth in GDP that can result from increased saving and risk taking. Many macroeconomists have concluded that reductions in the taxation of capital gains will increase GDP and wage growth sufficiently that future tax revenues from the taxation of wages and business profits will offset the losses forecast from the sale of capital assets. Allen Sinai, chief global economist at Lehman Brothers, has estimated that a reduction in capital gains taxation will raise real and nominal gross domestic product by increasing capital spending and capital formation and, thereby, increase future government revenues. The Committee also notes that a recent study by the economic forecasting firm, Data Resources, Inc., of a reduction in the taxation of capital gains similar to that adopted by the Committee suggests "that after 10 years real GDP could be 0.4% higher than in the baseline."[19] The potential for future growth and its benefits both for all United States citizens and for future Federal revenues were important considerations for the Committee.

The Committee rejects the narrow view that reductions in the taxation of capital gains benefit primarily higher-income Americans. Traditional attempts to measure the benefit of a tax reduction for capital gains are deficient. Typically, the classification of individuals in such studies measure the individuals' incomes including any capital gains realized. Many Americans realize only one or two capital gains during their lifetime, for example upon the sale of family business upon retirement. Including the gain on such a one-time sale in the income of the individual makes the individual appear, for that one year, to be a higher-income taxpayer when, in other years, the taxpayer would appear to be solidly middle class. Another deficiency is that such studies classify taxpayers only by their current economic condition. Studies show that there is substantial economic mobility in the United States. An individual who might be counted as lower income now may in a decade be higher income.

Thus, taking a longer view, the Committee sees a reduction in the taxation of capital gains as providing potential benefits to all individuals. Most importantly, the Committee stresses that economic growth benefits all Americans. Increased investment leads to greater productivity and leads to higher wages. Traditional attempts to measure the benefit or burden of a tax change do not account for this critical outcome.

Explanation of Provision

The bill allows individuals a deduction equal to 50 percent of net capital gain for the taxable year. The bill repeals the present-law maximum 28-percent rate. Thus, under the bill, the effective rate on the net capital gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket is 19.8 percent.

The bill repeals the provisions in the Revenue Reconciliation Act of 1993 providing a capital gain exclusion for sales of certain small business stock (sec. 1202 of the Code).

The bill reinstates the rule in effect prior to the l986 Tax Reform Act that required two dollars of the long-term capital loss of an in-

[19] Roger E. Brinner, David A. Wyss, and Cynthia M. Latta, "Growth and Budget Repercussions of the Republican *Contract with America*," *Review of the U.S. Economy*, DRI/McGraw-Hill, February 1995, p. 36.

dividual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income continues to apply.

Collectibles are excluded from net capital gain. However, an individual could elect to apply a maximum rate of 28 percent to the net capital gain attributable to collectibles, if the individual forgoes the benefit of indexing the basis of the collectible.

Effective Date

The provision generally applies to taxable years ending after December 31, 1994.

For a taxpayer's fiscal year that includes January 1, 1995 (or for the 1995 calendar year of a taxpayer holding interests in one or more pass-thru entities with a fiscal year that includes January 1, 1995), the 50-percent capital gains deduction applies to the lesser of (1) the net capital gain for the taxable year, or (2) the net capital gain determined by taking into account gain or loss properly taken into account for the portion of the taxable year after December 31, 1994. Any net capital gain not eligible for the 50-percent capital gains deduction is subject to the present-law maximum rate of 28 percent. This generally has the effect of applying the 50-percent deduction to capital assets sold or exchanged (or installment payments received) on or after January 1, 1995, and subjecting gains from capital assets sold before that date to a maximum rate of 28 percent.

In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph. Thus, gain taken into account by a fiscal-year pass-thru entity in 1994 which an owner takes into account on its calendar-year 1995 income tax return is not eligible for the new capital gains deduction.

A taxpayer holding small business stock on the date of enactment is able to elect, within one year from the date of enactment, to have the provision of present law (rather than the provisions of the bill) apply to any gain from the sale of the stock.

The capital loss rule does not apply to losses arising in taxable years beginning before January 1, 1996.

2. Indexing of basis of certain assets for purposes of determining gain (sec. 302 of bill and new sec. 1022 of the Code)

Present Law

Under present law, gain or loss from the disposition of any asset generally is the sales price of the asset is reduced by the taxpayer's adjusted basis in that asset. The taxpayer's adjusted basis generally is the taxpayer's cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflation.

Reasons for Change

Because a taxpayer's adjusted basis for tax purposes is determined by historical cost, a taxpayer can have gains for tax purposes even though the real value of the assets (i.e., adjusted for inflation) has not increased. Even at modest inflation rates of three percent per year for five years, an investor's adjusted basis will under-represent his real purchasing power by 16 percent over five years. The taxation of these inflationary gains discourages new saving and investors from selling old investments even when better investment opportunities present themselves. This retards economic growth and leads to an inefficient allocation of capital by the capital markets. For this reason, the Committee believes it is appropriate to provide for inflation adjustments to a taxpayer's adjusted basis in certain assets (held for more than three years) for purposes of determining gain on their disposition.

Explanation of Provision

In general

The bill generally provides for an inflation adjustment to (i. e. , indexing of) the adjusted basis of certain assets (called "indexed assets") for purposes of determining gain (but not loss) upon a sale or other disposition of such assets by a taxpayer other than a C corporation. Assets held by trusts, estates, S corporations, regulated investment companies ("RICs"), real estate investment trusts ("REITs"), and partnerships are eligible for indexing, to the extent gain on such assets is taken into account by taxpayers other than C corporations.

The bill applies to assets acquired on or after January 1, 1995 (and to principal residences held on that date).

Indexed assets

Assets eligible for the inflation adjustment generally include common (but not preferred) stock of C corporations and tangible property that are capital assets or property used in a trade or business. To be eligible for indexing, an asset must be held by the taxpayer for more than three years.

The adjusted basis of debt is not indexed. The proposal also excludes from indexing intangible assets, such as options, futures, and other derivatives.

No property using neutral cost recovery is an indexed asset.

Computation of inflation adjustment

The inflation adjustment under the provision is computed by multiplying the taxpayer's adjusted basis in the indexed asset by an inflation adjustment percentage. The inflation adjustment percentage is the percentage by which the GDP deflator for the last calendar quarter ending before the disposition exceeds the GDP deflator for the last calendar quarter ending before the asset was acquired by the taxpayer. The inflation adjustment percentage is rounded to the nearest one-tenth of a percent. No adjustment is made if the inflation adjustment is one or less.

Indexing with respect to any asset ends at the time the asset is treated as disposed of for tax purposes. Thus, with respect to installment sales, the inflation adjustment to the seller does not take into account any periods after the sale is made. The purchaser generally is entitled to inflation adjustments beginning with the date of purchase, even though the purchase price is not paid until a later date.

In computing the inflation ratio, periods of time for which an asset is not an indexed asset are not taken into account. For example, if convertible debt is converted into common stock, the period prior to conversion is disregarded in determining the inflation ratio applicable to the disposition of the common stock.

Special entities

RICs and REITs

In the case of a RIC or a REIT, the indexing adjustments generally apply in computing the taxable income and the earnings and profits of the RIC or REIT. The indexing adjustments, however, are not applicable in determining whether a corporation qualifies as a RIC or REIT.

In order to deny the benefit of indexing to corporate shareholders of the RIC or REIT, the bill provides that, under regulations, (1) the determination of whether a distribution to a corporate shareholder is a dividend is made without regard to this provision, (2) the amount treated as a capital gain dividend is increased to take into account that the amount distributed was reduced by reason of the indexing adjustment, and (3) such other adjustments as are necessary shall be made to ensure that the benefits of indexing are not allowed to corporate shareholders.

In the case of shares held in a RIC or REIT, partial indexing generally is provided by the provision based on the ratio of the value of indexed assets held by the entity to the value of all its assets. The ratio of indexed assets to total assets is determined quarterly (for RICs, the quarterly ratio is based on a three-month average). If the ratio of indexed assets to total assets exceeds 80 percent in any quarter, full indexing of the shares is allowed for that quarter. If less than 20 percent of the assets are indexed assets in any quarter, no indexing is allowed for that quarter for the shares. Partnership interests held by a RIC or REIT are subject to a look-through test for purposes of determining whether, and to what degree, the shares in the RIC or REIT are indexed.

A return of capital distribution by a RIC or REIT generally is treated by a shareholder as allocable to stock acquired by the shareholder in the order in which the stock was acquired.

Partnership and S corporations, etc.

Under the provision, stock in an S corporation or an interest in a partnership or common trust fund is not an indexed asset. [20] This rule avoids the complexity that would result in determining the proper measure of the basis adjustment if indexing were to take into account the fluctuating basis of the S corporation stock or partnership interest attributable to earnings and distributions or to the frequently changing mix of assets (i.e., indexed assets and

[20] An interest in a real estate mortgage investment conduit ("REMIC") also is not an indexed asset, since a REMIC is not treated as a corporation for income tax purposes.

other assets) of the entity. Under the provision, the individual owner receives the benefit of the indexing adjustment when the S corporation, partnership, or common trust fund disposes of indexed assets. Under the provision, any inflation adjustments at the entity level flows through to the holders and result in a corresponding increase in the basis of the holder's interest in the entity. Where a partnership has a section 754 election in effect, a partner transferring his interest in the partnership is entitled to any indexing adjustment that has accrued at the partnership level with respect to the partner and the transferee partner is entitled to the benefits of indexing for inflation occurring after the transfer.

The indexing adjustment is disregarded in determining any loss on the sale of an interest in a partnership, S corporation or common trust fund.

Example 1.—A, B, and C form an equal partnership, and each contributes $50 cash. The partnership purchases common stock in corporation X for $150. At a time when the indexed basis to the partnership for the stock is $240, the partnership sells the stock for $300. Under the bill, the partnership recognizes $60 gain. Each partner takes into account $20 gain and increases his basis in his partnership interest by the $20 gain (under present law sec. 705). In addition, under the bill each partner increases his basis for purposes of determining gain on his partnership interest by $30 (his share of the $90 indexing adjustment made by the partnership). Thus, if any partner sells his partnership interest for $100, no gain or loss is recognized to the partner.

Example 2.—Same facts as in Example 1, except that the partnership does not sell the stock. Rather, partner A sells his partnership interest to D for $100. The partnership does not have an election under section 754 in effect. Partner A recognizes $50 of gain. Partner D's basis in the partnership is the $100 purchase price. Assume that after the sale by A, the partnership sells the stock for $300 (at a time when the indexed basis is $240). The partnership recognizes $60 of gain and each partner takes into account $20 gain and makes the same adjustments as in the above example. If partner D then sold his partnership interest for $100, he will recognize a loss of $20 ($100 amount realized less adjusted basis for purposes of determining loss of $120; the $30 inflation adjustment would be disregarded in computing D's adjusted basis in his partnership interest.)

Example 3.—Same facts as in Example 2, except that the partnership has an election under section 754 in effect. When A sells his partnership interest to D, A recognizes $20 of gain, because under the bill, A's share of the partnership indexing adjustment is available to A at that time. Upon the sale of the stock by the partnership, D recognizes no gain or loss since the adjustment under section 743(b) had been made with respect to his share of the partnership properties. No adjustment is made by D to the basis in his partnership interest as a result of the sale by the partnership.

Foreign corporations

Common stock of a foreign corporation generally is an indexed asset if the stock is regularly traded on an established securities market. The Committee intends that the terms "regularly traded" and "established securities market" have the same meaning under the bill as they have in Treas. Reg. 1. 884–5(d). Indexed assets, however, do not include stock in a foreign investment company, a passive foreign investment company (including a qualified electing fund), a foreign personal holding company, or, in the hands of a shareholder who meets the requirements of section 1248(a)(2) (generally pertaining to 10-percent shareholders of controlled foreign corporations), any other foreign corporation. An American Depository Receipt (ADR) for common stock in a foreign corporation is treated as common stock in the foreign corporation and, therefore, the basis in an ADR for common stock generally is indexed.

Other rules

Improvements and contributions to capital

No indexing is provided for improvements or contributions to capital if the aggregate amount of the improvements or contributions to capital during the taxable year with respect to the property or stock is less than $1,000. If the aggregate amount of such improvements or contributions to capital is $1,000 or more, each addition is treated as a separate asset acquired at the close of the taxable year.

Suspension of holding period

No indexing adjustment is allowed during any period during which there is a substantial diminution of the taxpayer's risk of loss from holding the indexed asset by reason of any transaction entered into by the taxpayer, or a related party.

Short sales

In the case of a short sale of an indexed asset with a short sale period in excess of three years, the provision requires that the amount realized be indexed for inflation for the short sale period.

Related parties

The bill does not index the basis of property for sales or dispositions between related persons, except to the extent the adjusted basis of property in the hands of the transferee is a substituted basis (e.g., gifts).

Collapsible corporations

Under the bill, indexing does not reduce the amount of ordinary gain that would be recognized in cases where a corporation is treated as a collapsible corporation (under sec. 341) with respect to a distribution or sale of stock.

Effective Date

The provision applies to property the holding period of which begins after December 31, 1994. The provisions also apply to a principal residence (within the meaning of section 1034) held by the taxpayer on January 1, 1995. For purposes of computing the inflation adjustment (including the holding period for purposes of the three-year holding period requirement), the residence will be treated as acquired on January 1, 1995.

A taxpayer holding any indexed asset (other than a principal residence) on January 1, 1995, may elect to treat the indexed asset as having been sold on such date for an amount equal to its fair market value, and as having been reacquired for an amount equal to such value. If the election is made, the asset would be eligible for indexing under the provision. Any gain resulting from the election would be treated as received on the date of the deemed sale, and would not be treated as gain from the sale or exchange of property between related persons under Code section 1239. Any loss would not be allowed (and the disallowed loss would not be added to the basis of the indexed asset). For readily traded securities, fair market value is the closing market price on the business day following January 1, 1995. For this purpose, "readily traded" means readily tradable on an established securities market or otherwise.

A taxpayer may make the above election with respect to some indexed assets and not with respect to others.

3. 25-percent corporate alternative tax for capital gains (sec. 311 of the bill and sec. 1201 of the Code)

Present Law

Under present law, the net capital gain of a corporation is taxed at the same rate as ordinary income, and subject to tax at graduated rates up to 35 percent. Prior to the Tax Reform Act of 1986, the net capital gain of a corporation was subject to a maximum effective tax rate of 28 percent (and the highest rate was 46 percent for ordinary income).

Reasons for Change

The Committee believes it is important that tax policy be conducive to economic growth. Economic growth cannot occur without saving, investment, and the willingness of businesses to take risks and exploit new market opportunities. The greater the pool of savings, the greater the monies available for business investment in equipment and research. It is through such investment in equipment and new products and services that the United States economy can increase output and productivity. It is through increases in productivity that workers earn higher real wages. Hence, greater saving is necessary for all Americans to benefit through a higher standard of living.

The Committee observes that net business saving has not increased significantly from its levels of a decade ago. The Committee believes that a lower rate of tax on capital gains will promote economic growth, create new jobs and encourage investment, saving, and risk-taking.

Explanation of Provision

The provision provides an alternative tax of 25 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

Effective Date

The provision generally applies to taxable years ending after December 31, 1994. For taxable years ending after December 31, 1994, and beginning before January 1, 1996, the 25-percent rate applies to the lesser of (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1994. This generally has the effect of applying the 25-percent alternative rate to gains from capital assets sold or exchanged on or after January 1, 1995, and subjecting gains from capital assets before that date to the regular 35-percent rate.

In the case of gain taken into account by a corporation from a pass-through entity (i.e., a RIC, a REIT, an S corporation, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph. Thus, gain taken into account by a fiscal-year pass-thru entity in 1994 which a corporate owner takes into account on its calendar-year 1995 income tax return is not eligible for the alternative tax on capital gains.

4. Capital loss deduction allowed with respect to the sale or exchange of a principal residence (sec. 316 of the bill and sec. 165 of the Code)

Present Law

Taxpayers generally may claim as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise. In the case of an individual, however, the deduction is limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit though not connected with a trade or business, and (3) catastrophic losses of property that arise from fire, storm, shipwreck, or other casualty or from theft. Deductions for losses from the sale or exchange of capital assets are subject to the limitations described above. In addition, taxpayers other than corporations may deduct capital losses against up to $3,000 of ordinary income each year.

A loss on the sale or exchange of a principal residence is treated as a nondeductible personal loss. Gain on the sale or exchange of a principal residence generally is includible in gross income and is subject to a maximum rate of 28 percent. If an individual purchases a new principal residence within two years of selling the old residence, gain from the sale of the old residence (if any) is recognized only to the extent that the taxpayer's adjusted sales price exceeds the taxpayer's cost of purchasing the new residence (sec. 1034). A taxpayer also may elect to exclude from gross income up to $125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale and (2) has used the residence as a principal residence for three or more years of the five years preceding the sale of the residence (sec. 121). This election may be made only once.

Reasons for Change

Generally, under present law if a taxpayer sells the taxpayer's principal residence for less than the taxpayer's adjusted basis in that asset the taxpayer is treated as having a nondeductible personal loss. In contrast, when a taxpayer sells an investment asset for less than the taxpayer's adjusted basis in that investment asset, the taxpayer may be eligible for capital loss treatment on the sale. That capital loss is available to offset the taxpayer's capital gains and $3000 of ordinary income annually. The Committee believes that it is inappropriate to allow the capital loss on the sale of the investment asset but not on the sale of the principal residence. Further, the Committee believes that the proper measurement of economic income under the Code requires a recognition of the large out-of-pocket loss that a taxpayer incurs when a taxpayer's principal residence is sold at a loss.

Explanation of Provision

The bill provides that a loss from the sale or exchange of a principal residence is treated as a deductible capital loss rather than a nondeductible personal loss.

Effective Date

The provision is effective for sales and exchanges after December 31, 1994, in taxable years ending after such date.

B. Cost Recovery Provisions

1. Neutral cost recovery (sec. 321 of the bill and secs. 56 and 168 of the Code)

Present Law

Under present law, a taxpayer is allowed depreciation deductions for the cost of property used in a trade or business. In general, depreciation for tangible property placed in service after 1986 is determined under the modified Accelerated Cost Recovery System ("MACRS") enacted as part of the Tax Reform Act of 1986. MACRS includes a general depreciation system and an alternative depreciation system.

Under the general MACRS rules, property is divided into nine classes based on recovery periods (3-year property, 5-year property, 7-year property, 10-year property, 15-year property, 20-year property, 27. 5-year residential rental property, 39-year nonresidential real property and 50-year railroad grading or tunnel bores) and is depreciated over such periods. The 200-percent declining balance method of depreciation is used for 3-year, 5-year, 7-year, and 10-year property; the 150-percent declining balance method is used for 15-year and 20-year property and property used in a farming business; and the straight-line method is used for other property (including real property).

The alternative depreciation system applies to foreign use property, tax-exempt use property, tax-exempt bond financed property, certain imported property, and property to which the taxpayer so elects, and is used to compute corporate earnings and profits. In general, the value of MACRS deductions are reduced under the alternative depreciation system by calculating depreciation using the straight-line method over the property's class life.[21] A property's class life generally corresponds to its Asset Depreciation Range ("ADR") midpoint life and often is longer than the recovery period available under the general MACRS. (The class lives and recovery periods of some assets are set by statute, regardless of the asset's ADR midpoint life.) The class lives of the alternative depreciation system are used for purposes of the corporate and individual alternative minimum taxes. The alternative minimum tax generally applies the 150-percent declining balance method to tangible personal property placed in service after 1993.

Reasons for Change

The ability of a business to recover its capital costs when determining its income subject to tax is critical in the decision to invest. In looking at the future investment needs of the United States, the Committee finds the present-law MACRS inadequate in two respects. First, the real value of the capital cost recovery available to business under MACRS depends upon the rate of inflation. Uncertainty about the real value of capital cost recovery discourages investment. The Committee believes that capital cost recovery provisions should be inflation proof. Second, the present value of the costs permitted to be recovered under present law is less than the cost of the investment. The Committee believes that, in order to provide the investment incentives necessary for growth in GDP and wages, the Internal Revenue Code should provide for the recovery of the real present value of capital outlays. The Committee believes that increasing the deductions currently allowable under MACRS by the rate of inflation and, for shorter-lived property, an assumed real interest rate factor of 3. 5 percent helps rectify both inadequacies of present law.

Explanation of Provision

For MACRS property placed in service after December 31, 1994, the bill allows a taxpayer to elect, on a property-by-property basis, to determine depreciation deductions under present law or under a new neutral cost recovery system ("NCRS"). The following describes the treatment of property under NCRS.

First, NCRS generally follows MACRS but would replace the 200-percent declining balance method of MACRS applicable to shorter-lived property with the 150-percent declining balance method.[22]

Second, depreciation for any taxable year after the year in which the property is placed in service would be determined by multiplying the deduction allowable for the property for the taxable year

[21] Annual depreciation deductions for passenger automobiles also are limited under section 280F.

[22] Thus, except as specifically provided, the elections that are generally available under MACRS are available under NCRS. For example, it is expected that a taxpayer will be allowed to elect to maintain general asset accounts with respect to NCRS property (sec. 168(i)(4)). However, some MACRS elections are not compatible with NCRS. For example, a taxpayer may not apply the 3.5-percent factor described below to shorter-lived property for which the taxpayer elects to apply the straight-line methods of depreciation under section 168(e)(5).

(determined without regard to this provision) by the "applicable neutral cost recovery ratio" for the year.

In the case of property that would otherwise qualify for the 200-percent declining balance method (but for the election to use NCRS), the applicable neutral cost recovery ratio for the taxable year is first determined by dividing (1) the gross domestic product deflator for the taxable year by (2) the gross domestic product deflator for the year the property was placed in service by the taxpayer. This ratio is then multiplied by the number equal to 1.035 raised to the nth power, where "n" is the number of full years since the property was placed in service by the taxpayer. In the case of other MACRS property (e.g., longer-lived property and property to which the alternative depreciation system applies), the applicable neutral cost recovery ratio for the taxable year is determined by dividing (1) the gross domestic product deflator for the taxable year by (2) the gross domestic product deflator for the year the property was placed in service by the taxpayer.

The gross domestic product deflator for any taxable year is the appropriate price deflator released by the Department of Commerce for the gross domestic product for the calendar quarter that includes the mid-point of the taxpayer's taxable year. The mid-point of a full taxable year generally is the 183rd day of such year.[23] Thus, for example, the gross domestic product deflator for a taxpayer with a fiscal year ending November 30 is the appropriate price deflator published for the calendar quarter ending June 30. The appropriate price deflator for any calendar quarter is the last deflator for such quarter released by the Department of Commerce before the end of the next calendar quarter.

For any property, the applicable neutral cost recovery ratio may not be less than one and is rounded to the nearest one-thousandth.

The depreciation allowances provided under NCRS for regular tax purposes also are applied for alternative minimum tax purposes. In addition, the component of the adjusted current earnings adjustment relating to earnings and profits (sec. 56(g)(4)(C)) does not apply to the additional deductions allowed under NCRS for purposes of the corporate alternative minimum tax.

The application of the applicable neutral cost recovery ratio generally is not taken into account for purposes of (1) determining the adjusted basis of depreciable property,[24] any interest in a pass-thru entity (as defined in sec. 1202(e)(2) as added by the bill to mean a regulated investment company, a real estate investment trust, an S corporation, a partnership, an estate or trust, or a common trust fund), or the stock of a consolidated subsidiary; (2) determining earnings and profits; or (3) the recapture provisions of sections 1245 and 1250. The additional deductions determined under NCRS are subject to the built-in loss rules of section 382 generally in the same manner as depreciation deductions are subject to such rules under present law. Finally, the additional deductions determined under NCRS are not subject to the at-risk rules to the extent the

---

[23] It is expected that the Secretary of the Treasury will provide such rules as are necessary to determine the appropriate price deflator for any taxable year that is a short year.

[24] The additional deductions allowed by the provision will increase the "unrecovered basis" of a passenger automobile to the extent such deductions are not allowed by reason of section 280F.

taxpayer's underlying MACRS depreciation deductions are not deemed to be subject to the at-risk rules.

NCRS does not apply to any property for which the taxpayer so elects [25] or to property placed in service pursuant to certain churning transactions.

Effective Date

The provision is effective for qualifying property placed in service after December 31, 1994.

2. Treatment of leasehold improvements (sec. 322 of the bill and sec. 168 of the Code)

Present Law

Depreciation of leasehold improvements

Improvements made on leased property are depreciated under the modified Accelerated Cost Recovery System ("MACRS"), even if the MACRS recovery period assigned to the property is longer than the term of the lease (sec. 168(i)(8)).[26] This rule applies regardless of whether the lessor or lessee places the leasehold improvements in service.[27] If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service (secs. 168(b)(3), (c)(1), (d)(2), and (i)(6)).[28]

Treatment of dispositions of leasehold improvements

A taxpayer generally recovers the adjusted basis of property for purposes of determining gain or loss upon the disposition of the property. Upon the termination of a lease, the adjusted basis of leasehold improvements that were made, but are not retained, by a lessee are taken into account to compute gain or loss by the lessee.[29] The proper treatment of the adjusted basis of improvements made by a lessor upon termination of a lease is less clear. Proposed Treasury regulation section 1.168–2(e)(1) provides that the unadjusted basis of a building's structural components must be recovered as whole. In addition, proposed Treasury regulation sec-

[25] Any election, once made, is irrevocable.

[26] Prior to the adoption of the Accelerated Cost Recovery System ("ACRS") by the Economic Recovery Tax Act of 1981, taxpayers were allowed to depreciate the various components of a building as separate assets with separate useful lives. The use of component depreciation was repealed upon the adoption of ACRS. The denial of component depreciation also applies under MACRS, as provided by the Tax Reform Act of 1986.

[27] Former Code sections 168(f)(6) and 178 provided that in certain circumstances, a lessee could recover the cost of leasehold improvements made over the remaining term of the lease. These provisions were repealed by the Tax Reform Act of 1986.

[28] If the improvement is characterized as tangible personal property, MACRS depreciation is calculated using the shorter recovery periods and accelerated methods applicable to such property. The determination of whether certain improvements are characterized as tangible personal property or as nonresidential real property often depends on whether or not the improvements constitute a "structural component" of a building (as defined by Treas. Reg. sec. 1.48–1(e)(1)). See, for example, *Metro National Corp.*, 52 TCM 1440 (1987); *King Radio Corp.*, 486 F.2d 1091 (10th Cir., 1973); *Mallinckrodt, Inc.*, 778 F.2d 402 (8th Cir., 1985) (with respect to various leasehold improvements).

[29] See, Report of the House Committee on Ways and Means on H.R. 3838 (H. Rept. 99–426), p. 158, and Senate Committee on Finance Report on H.R. 3838 (S. Rept. 99–313), p. 105 (Tax Reform Act of 1986, 99th Cong.).

tions 1.168–2(l)(1) and 1.168–6(b) provide that "disposition" does not include the retirement of a structural component of real property if there is no disposition of the underlying building.[30] Thus, it appears that it is the position of the Internal Revenue Service that leasehold improvements made by a lessor that constitute structural components of a building must continue to be depreciated in the same manner as the underlying real property, even if such improvements are retired at the end of the lease term.[31] Some lessors, on the other hand, may be taking the position that a leasehold improvement is a property separate and distinct from the underlying building and that an abandonment loss under section 165 is allowable at the end of the lease term for the adjusted basis of the abandoned property. In addition, lessors may argue that even if a leasehold improvement constitutes a structural component of a building, proposed Treasury regulation section 1.168–2(l)(1) (that seemingly denies the deduction at the end of the lease term) applies only to retirements, but not abandonments or demolitions, of such property.[32] Thus, it appears that some lessors take the position that, at least in certain circumstances, the adjusted bases of leasehold improvements may be recovered at the end of the term of the lease to which the improvements relate even if there is no disposition of the underlying building.

Reasons for Change

The Committee believes that costs that relate to the leasing of property should not be recovered beyond the term of the lease to the extent the costs do not provide a future benefit beyond such term. The Committee also believes that the proper present-law treatment of leasehold improvements disposed of at the end of the term of a lease is unclear. Thus, the Committee would provide that the unrecovered costs of leasehold improvements that were placed in service by a lessor with respect to a lease and that are irrevocably disposed of at the end of the lease term should be taken into account at that time.

Explanation of Provision

Under the bill, a lessor of leased property that disposes of a leasehold improvement which was made by the lessor for the lessee of the property may take the adjusted basis of the improvement into account for purposes of determining gain or loss if the improvement is irrevocably disposed of or abandoned by the lessor at the termination of the lease. The bill thus conforms the treatment of lessors and lessees with respect to leasehold improvements disposed of at the end of a term of lease.

For purposes of applying the provision, it is expected that a lessor must be able to separately account for the adjusted basis of the

[30] For example, if a taxpayer places a new roof on building subject to ACRS, the taxpayer must continue to depreciate the allocable cost of the old roof as part of the cost of the underlying building. (Prop. Treas. reg. sec. 1.168–6(b)(1)) See, also, Joint Committee on Taxation, *General Explanation of the Economic Recovery Tax Act of 1981* (97th Cong.), p. 86.

[31] See, IRS General Information Letter, dated Sept. 17, 1992.

[32] Compare the second and fourth sentences of proposed Treasury regulation section 1.168–2(l)(1).

leasehold improvement that is irrevocably disposed of or abandoned.

Effective Date

The provision is effective for leasehold improvements disposed of after March 13, 1995. No inference is intended as to the proper treatment of such dispositions before March 14, 1995, or to the dispositions of other property.

C. Alternative Minimum Tax (sec. 331 of the bill and secs. 55 through 59 of the Code)

Present Law

In general

Present law imposes a minimum tax (known as the alternative minimum tax ("AMT")) on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. The individual minimum tax is imposed at rates of 26 and 28 percent on alternative minimum taxable income in excess of a phased-out exemption amount; the corporate minimum tax is imposed at a rate of 20 percent on alternative minimum taxable income in excess of a phased-out $40,000 exemption amount.[33] Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. In the case of a corporation, in addition to the regular set of adjustments and preferences, there is a second set of adjustments known as the "adjusted current earnings" adjustment.

Preference items in computing AMTI

The minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. For taxable years beginning after 1992, this preference does not apply to percentage depletion allowed with respect to oil and gas properties.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. For taxable years beginning after 1992, this preference does not apply to independent producers to the extent the producer's AMTI is reduced by 40 percent or less by ignoring the preference.

(3) The amount that a financial institution's bad debt deduction determined under section 593 exceeds the amount that would have determined based on the institution's actual experience.

(4) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

[33] In addition, in the case of a corporation, section 59A imposes an environmental tax at a rate of 0.12 percent on modified AMTI in excess of a $2,000,000 exemption amount. Environmental tax collections are dedicated to the Hazardous Substance Superfund. This tax is scheduled to expire for taxable years beginning after December 31, 1995.

(5) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

(6) One-half of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm or passive activities are denied.[34]

Adjustments in computing AMTI

The adjustments that all taxpayers must make are:

(1) Depreciation on property placed in service after 1986 must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property.

(2) Mining exploration and development costs must be capitalized and amortized over a 10-year period.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

(4) The amortization deduction allowed for pollution control facilities (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax) must be calculated under the alternative depreciation system.

(5) Dealers in property (other than certain dealers of timeshares and residential lots) may not use the installment method of accounting.

The adjustments applicable to individuals are:

(1) Miscellaneous itemized deductions (generally those that are allowable against the regular tax if they are in excess of two percent of the taxpayer's adjusted gross income);

(2) State, local, and foreign real property taxes; state and local personal property taxes; and state, local, and foreign income, war profits, and excess profits taxes;

(3) Medical expenses except to the extent in excess of ten percent of the taxpayer's adjusted gross income;

(4) Standard deductions and personal exemptions;

(5) The amount allowable as a deduction for circulation expenditures must be capitalized and amortized over a three-year period;

(6) The amount allowable as a deduction for research and experimental expenditures must be capitalized and amortized over a 10-year period;[35] and

(7) The special rules relating to incentive stock options.

The adjustments applicable to corporations are:

(1) The special rules applicable to Merchant Marine capital construction funds;

(2) The special deduction allowable under section 833(b) (relating to Blue Cross and Blue Shield organizations); and

---

[34] Given the full applicability of section 469 (relating to the deductibility of losses from passive activities) following a phase-in period after the passage of the Tax Reform Act of 1986, these provisions are largely deadwood.

[35] No adjustment is required if the taxpayer materially participates in the activity that relates to the research and experimental expenditures.

(3) The adjusted current earnings adjustment, described below.

Adjusted current earnings (ACE) adjustment

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings ("ACE") of a corporation exceeds its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction).[36] In determining ACE, the following rules apply:

(1) For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.[37]

(2) Any amount that is excluded from gross income under the regular tax but is included for purposes of determining earnings and profits is included in determining ACE.[38]

(3) The inside build-up of a life insurance contract is includible in ACE (and the related premiums are deductible).

(4) Intangible drilling costs (other than those incurred by an independent producer after 1992) must be capitalized and amortized over a 60-month period.

(5) The regular tax rules of sections 173 (allowing circulation expenditures to be expensed) and 248 (allowing organizational expenditures to be amortized) do not apply.

(6) Inventory must be calculated using the FIFO, rather than LIFO, method.

(7) The installment sales method generally may not be used.

(8) No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

(9) Depletion (other than depletion claimed by an independent producer after 1992) must be calculated using the cost, rather than the percentage, method; and

(10) In certain cases, the assets of a corporation that has undergone an ownership change must be stepped-down to their fair market values.

Other rules

The combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's AMT by more than 90 percent of the amount determined without these items.

The various credits allowed under the regular tax generally are not allowed against the AMT.

If a taxpayer is subject to AMT in any year, such amount of tax is allowed as a credit in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in such subsequent year. If the taxpayer is an individual, this

---

[36] If ACE is less than AMTI, the ACE adjustment may reduce AMTI to the extent of prior-year ACE inclusions.

[37] Pursuant to a provision in the Omnibus Budget Reconciliation Act of 1993, ACE depreciation adjustments are not required for property placed in service after 1993.

[38] Exceptions and special rules are provided for related expenses that are not deductible for regular tax purposes but reduce earnings and profits, the dividends received deduction relating to certain dividends, taxes on dividends from 936 companies, and certain dividends received by certain cooperatives.

credit is allowed to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature.

Reasons for Change

The Committee believes that the AMT inhibits capital formation and business enterprise. Therefore, the bill repeals the business-related adjustments and preferences contained in the present-law AMT with respect to new investment and prospective transactions. In addition, the Committee believes that the AMT is administratively complex. Therefore, the bill completely repeals the corporate AMT after an initial phase-in period so that corporate taxpayers would not be required to maintain AMT records for the few remaining adjustments relating to pre-effective date investments.

Explanation of Provision

Repeal of the corporate alternative minimum tax

The bill repeals the corporate AMT for taxable years beginning after December 31, 2000. In addition, as described below, the bill makes certain changes to the individual AMT, and to the corporate AMT for taxable years beginning before January 1, 2001.[39] The individual AMT, as amended by the bill, will remain in existence.

Preference items in computing AMTI

The bill makes the following changes to the minimum tax preference items:

(1) The preference relating to depletion is repealed for depletion claimed in taxable years beginning after December 31, 1995.

(2) The preference relating to excess intangible drilling costs is repealed for costs incurred in taxable years beginning after December 31, 1995.

(3) The preference relating to bad debt losses of financial institutions is repealed for taxable years beginning after December 31, 1995.

(4) In the case of a corporation (other than an S corporation, regulated investment company, real estate investment trust, or REMIC), the preference relating to tax-exempt interest on private activity bonds is repealed for interest accruing after December 31, 1995.

In addition, Code section 58 (relating to tax shelter farm activity and passive losses) is repealed for taxable years beginning after December 31, 1995. An individual that has a loss from a tax shelter farm activity arising in a taxable year beginning after December 31, 1995, (or arising in prior year and being carried forward), may use such loss in computing the individual's AMTI for a taxable year beginning after December 31, 1995 (to the extent such loss is otherwise allowable after taking into account such limitations as the passive activity and at-risk rules). The bill moves the passive activity rules of present-law section 58 to section 59(h).

[39] These changes made to the corporate AMT will also apply for purposes of section 59A.

Adjustments in computing AMTI

The bill makes the following changes to the adjustments used in computing AMTI:

(1) The adjustment relating to depreciation is repealed for property placed in service after March 13, 1995. Under another provision of the bill, property to which the proposed neutral cost recovery system applies is not subject to the AMT depreciation adjustment. The neutral cost recovery system generally applies to qualified property placed in service after December 31, 1994, unless the taxpayer irrevocably elects, on a property-by-property basis, to not have the system apply.

(2) The adjustment relating to mining exploration and development costs is repealed for costs paid or incurred after December 31, 1995.

(3) The adjustment relating to long-term contracts is repealed for contracts entered into after December 31, 1995.

(4) The adjustment relating to pollution control facilities is repealed for property placed in service after December 31, 1995.

(5) The adjustment relating to installment sales is repealed for dispositions after December 31, 1995.

(6) The adjustments relating to circulation and research and experimental expenditures of individuals is repealed for costs paid or incurred after December 31, 1995.

(7) The adjustment relating to Merchant Marine capital construction funds of corporations is repealed for deposits made to a fund after December 31, 1995, and to earnings received or accrued after December 31, 1995, on amounts in such funds. Withdrawals of deposits and earnings from a fund after December 31, 1995, will be treated as allocable: (a) first to deposits (and earnings received or accrued) before January 1, 1987; (b) then, to deposits (and earnings received or accrued) after December 31, 1986, and before January 1, 1996; and (c) then, to deposits (and earnings received or accrued) after December 31, 1995.

(8) The denial of the special deduction allowed under section 833(b) is repealed for taxable years beginning after December 31, 1995.

Adjusted current earnings (ACE) adjustment

The bill makes the following changes to the ACE adjustment of the corporate AMT:

(1) The ACE rules relating to the inclusion (or deduction) of items included (or excluded) from the calculation of earnings and profits are repealed for taxable years beginning after December 31, 1995.

(2) The ACE adjustment relating to intangible drilling costs is repealed for amounts paid or incurred after December 31, 1995.

(3) The ACE adjustments relating to section 173 and section 248 costs are repealed for amounts paid or incurred after December 31, 1995.

(4) The ACE adjustment relating to LIFO inventory is repealed for LIFO adjustments arising in taxable years beginning after December 31, 1995.

(5) The ACE adjustment relating to installment sales is repealed for sales after December 31, 1995.

(6) The ACE adjustment relating to the exchange of debt pools is repealed for exchanges after December 31, 1995.

(7) The ACE adjustment relating to built-in losses with respect to certain changes of ownership is repealed for ownership changes after December 31, 1995.

(8) The ACE adjustment relating to depletion is repealed for depletion allowed in taxable years beginning after December 31, 1995.

Use of credits

The special rules relating to the use of net operating losses and foreign tax credits are repealed for net operating losses and foreign tax credits used in taxable years beginning after December 31, 1995. Carrybacks of losses and credits to taxable years beginning before January 1, 1996, continue to be subject to the 90-percent limitations.

The bill does not change the rules regarding the availability of other credits against the AMT.

For taxable years beginning after December 31, 1995, a taxpayer with alternative minimum tax credit carryovers is allowed to use these credits to offset 90 percent of its regular tax liability (determined after the application of other credits as under present law). As under present law, in no event may alternative minimum tax credit carryovers be used to reduce the taxpayer's tax liability below its tentative minimum tax, if any.

Effective Date

Except as provided above, the provision is effective for taxable years beginning after December 31, 1995.

D. Public Debt Reduction Checkoff and Trust Fund (secs. 341 and 342 of the bill and new secs. 6097 and 9512 of the Code)

Present Law

The Presidential Election Campaign Fund ("Campaign Fund") provides for public financing of a portion of qualified Presidential election campaign expenditures and certain convention costs (sec. 9001 et seq.) The Campaign Fund is financed through the voluntary designation by individual taxpayers on their Federal income tax returns of $3 of tax liability, which is commonly known as the Presidential election campaign checkoff (sec. 6096). This checkoff can be made only by individuals (not corporations) and does not affect the individual's tax liability.[40] The Treasury Department accumulates revenues in the Campaign Fund over a four-year period

---

[40] Prior to enactment of the Revenue Reconciliation Act of 1993, individuals could designate $1 of their Federal income tax liability to the Campaign Fund. For calendar year 1992, 20.5 million returns, or 18 percent of the total number of individual income tax returns, designated a total of $29.6 million in contributions to the Campaign Fund. See Statement of Maurice B. Foley, Deputy Tax Legislative Counsel (Tax Legislation), Department of the Treasury, before the Ways and Means Subcommittee on Select Revenue Measures, U. S. House of Representatives, November 16, 1993.

and then disburses funds to eligible candidates for President, Vice President, and conventions during the Presidential election year.[41]

Individuals who itemize deductions (as well as corporations) are allowed a deduction, subject to certain limitations, for contributions made to qualified charitable organizations or to Federal, State, and local governments. Instructions to IRS income tax forms inform taxpayers that they may make a gift to the Federal Government to reduce the public debt by enclosing with their return a separate check made payable to the "Bureau of Public Debt." In addition, various public laws provide that contributions to specific Federal entities or programs are regarded as gifts to the United States. Such contributions to the Bureau of Public Debt and to specific Federal entities or programs are deductible if the donor itemizes deductions for the year in which the contribution is made.

Reasons for Change

The Committee believes that eliminating the Federal budget deficit and reducing the outstanding public debt is crucial to the nation's long-term economic growth. It is, therefore, appropriate to give taxpayers a more direct voice in the Federal budget process and to impose additional discipline on spending by the Federal government. The provision will allow taxpayers to earmark funds to reduce the current Federal deficit, which will reduce government borrowing and increase funds available for private investment, thereby contributing to long-term economic growth. If taxpayers elect to designate sufficient amounts under the provision to reduce the outstanding national debt, the interest expense of the Federal government would be reduced, permitting government funds otherwise needed to pay interest charges to be used for other public purposes. Reducing the outstanding national debt also will lessen the tax burden on future generations.

Explanation of Provision

Individual taxpayers will be allowed to designate an amount up to 10 percent of their Federal income tax liability for a taxable year to be earmarked to reduce the Federal public debt. Such a designation may be made only at the time the taxpayer files his or her income tax return for a particular taxable year. An individual's decision whether or not to make a designation under the provision will not affect his or her tax liability. If an individual has no Federal income tax liability for a taxable year—i.e, the individual owes no Federal income tax after claiming allowable credits (other than the EITC) and any designation to the Presidential Election Campaign Fund—then such individual will not be allowed to make a designation to reduce the Federal debt on his or her return for that year.

Under the bill, amounts earmarked by taxpayers to reduce the public debt will be transferred into a Public Debt Reduction Trust Fund, which will be used only to retire or purchase Federal securities (other than obligations held by the Social Security Trust Fund,

[41] A number of States provide checkoffs on their income tax forms to permit taxpayers to fund State electoral campaigns, private charitable organizations, and State governmental programs. Some of the State programs require taxpayers to pay additional amounts to exercise the checkoff option, generally by accepting a smaller refund.

the Civil Service Retirement and Disability Fund, and the Department of Defense Military Retirement Fund). Related provisions (outside the jurisdiction of the Committee and, thus, not included in the bill) will require either specific spending cuts or an across-the-board sequestration in Federal spending (with certain exceptions) to match the amounts designated by taxpayers for debt reduction.

Effective Date

The provision is effective for taxable years ending after the date of enactment, and will remain in effect until the entire outstanding Federal public debt is retired.

E. Small Business Incentives

1. Increase in unified estate and gift tax credit; indexing of certain provisions (sec. 351 of the bill and secs. 2001(c), 2010, 2032A, 2102(c), 2503, 2505(a), 2631, 6018(a), and 6601(j) of the Code)

Present Law

Application of the estate and gift tax

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.[42] Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million (sec. 2001(c)).

The amount of gift tax payable for any calendar year generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative lifetime taxable transfers made by the taxpayer and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period.

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800 (sec. 2010), which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a 5-percent surtax imposed

[42] Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

upon cumulative taxable transfers over $10 million and not exceeding $21,040,000 (sec. 2001(c)(2)).[43]

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted $175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of $47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an effective exemption of $225,000 in 1982 to an effective exemption of $600,000 in 1987. The unified credit has not been increased since 1987.

Annual exclusion for gifts

A taxpayer may exclude $10,000 of gifts made to any one donee during a calendar year (sec. 2503). This annual exclusion does not apply to gifts of future interests (e.g., reversions or remainders). Prior to 1982, the annual exclusion was $3,000.

Special use valuation

Generally, for Federal transfer tax purposes, the value of property is its fair market value, i.e., the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Under Code section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. Currently, the maximum reduction in the value of such real property resulting from an election under Code section 2032A is $750,000.

Generation-skipping transfer tax

A generation-skipping transfer tax ("GST tax") generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations and taxable distributions.[44]

A person is allowed an exemption from the GST tax of up to $1,000,000 for generation-skipping transfers made during life or at death (sec. 2631).

Installment payment of estate tax

Under Code section 6166, an executor generally may elect to pay the Federal estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period. To qualify for the election, the business must be an active trade or business

[43] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her average transfer tax rate will be 55 percent under present law.

[44] For this purpose, a direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person (e.g., a gift from grandparent to grandchild). A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or a direct skip).

and the value of the decedent's interest in the closely held business must exceed 35 percent of the decedent's adjusted gross estate.

If an election is made, the estate pays only interest for the first four years, followed by up to ten annual installments of principal and interest. Interest is generally imposed at the rate applicable to underpayments of tax under Code section 6621 (i.e., the Federal short term rate plus three percentage points). Under Code section 6601(j), however, a special 4-percent interest rate applies to the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely-held business. The maximum amount that may be subject to the 4-percent rate is the lower of (1) $345,800 (i.e., the amount of estate tax on the first $1,000,000), less the amount of allowable unified credit, or (2) the amount of estate tax attributable to the closely-held business that is being paid in installments pursuant to Code section 6166.

Reasons for Change

The Committee believes that increasing the amount of the estate and gift tax unified credit will encourage saving, promote capital formation and entrepreneurial activity, and help to preserve existing family-owned farms and businesses. The Committee further believes that indexing the unified credit exemption equivalent amount (as well as other similar amounts) for inflation is appropriate to reduce the transfer tax consequences that result from increases in asset value attributable solely to inflation.

Explanation of Provisions

Increase in unified credit

The bill increases the present-law unified credit of $192,800 to $248,300 over a three-year period beginning in 1996. For decedents dying and gifts made in 1996, the unified credit is $229,800 (i.e., the amount that would effectively exempt $700,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made in 1997, the unified credit is $239,050 (i.e., the amount that would effectively exempt $725,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made after 1997, the unified credit is $248,300 (i.e., the amount that would effectively exempt $750,000 in taxable transfers from the estate and gift tax). After 1998, the unified credit is indexed for inflation each year by multiplying the applicable exclusion amount of $750,000 by a cost of living adjustment. The indexed exclusion amount is rounded to the nearest $10,000.

To reflect the increase in the unified credit, the bill also makes conforming amendments to (1) the 5-percent surtax in order to permit the proper phase out of the increased unified credit, (2) the general filing requirements for estate and gift tax returns under Code section 6018(a), and (3) the amount of the unified credit allowed under Code section 2102(c)(3) with respect to nonresident aliens with U. S. situs property who are residents of certain treaty countries.

Indexing of certain other provisions

In addition to increasing and indexing the unified credit, the bill indexes the following amounts for inflation beginning after 1998: (1) the $10,000 annual exclusion for gifts; (2) the $750,000 ceiling amount on special use valuation under Code section 2032A; (3) the $1,000,000 generation-skipping transfer tax exemption; and (4) the value of a closely-held business (i.e., $1,000,000) eligible for the special four-percent interest rate under Code section 6601(j). Indexing of the annual exclusion is rounded to the nearest $1,000 and indexing of the other amounts is rounded to the nearest $10,000.

Effective Date

The provisions apply to the estates of decedents dying, and gifts made, after December 31, 1995.

2. Increase in expensing for small businesses (sec. 352 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).[45] 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. In order to increase the value of these benefits, the Committee would, after a phase-in period, double 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 $35,000. The increase is phased in as follows:

Taxable year beginning in—	*Maximum expensing*
1996	$22,500

[45] 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).

Taxable year beginning in—	Maximum expensing
1997	27,500
1998	32,500
1999 and thereafter	35,000

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.

3. Clarification of definition of principal place of business; Treatment of storage of product samples (secs. 353 and 354 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)).[46] These rules apply to houses, apartments, condominiums, mobile homes, boats, and other similar property used as the taxpayer's home (sec. 280A(f)(1)). Under Internal Revenue Service (IRS) rulings, the deductibility of expenses incurred for local transportation between a taxpayer's home and a work location sometimes depends on whether the taxpayer's home office qualifies under section 280A(c)(1) as a principal place of business (see Rev. Rul. 94–47, 1994–29 I.R.B. 6).

Prior to 1976, expenses attributable to the business use of a residence were deductible whenever they were "appropriate and helpful" to the taxpayer's business. In 1976, Congress adopted section 280A, in order to provide a narrower scope for the home office deduction, but did not define the term "principal place of business." In *Commissioner* v. *Soliman*, 113 S. Ct. 701 (1993), the Supreme Court reversed lower court rulings and upheld an IRS interpretation of section 280A that disallowed a home office deduction for a self-employed anesthesiologist who practiced at several hospitals but was not provided office space at the hospitals. Although the anesthesiologist used a room in his home exclusively to perform administrative and management activities for his profession (i.e., he spent two or three hours a day in his home office on bookkeeping, correspondence, reading medical journals, and communicating with surgeons, patients, and insurance companies), the Supreme Court

[46] If an employer provides access to suitable space on the employer's premises for the conduct by an employee of particular duties, then, if the employee opts to conduct such duties at home as a matter of personal preference, the employee's use of the home office is not "for the convenience of the employer." See, e.g., *W. Michael Mathes,* (1990) T.C. Memo 1990–483.

upheld the IRS position that the "principal place of business" for the taxpayer was not the home office, because the taxpayer performed the "essence of the professional service" at the hospitals.[47] Because the taxpayer did not meet with patients at his home office and the room was not a separate structure, a deduction was not available under the second or third exception under section 280A(c)(1) (described above).

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 the Supreme Court's decision in *Soliman* unfairly denies a home office deduction to a growing number of taxpayers who manage their business activities from their homes. Thus, the statutory modification adopted by the Committee will reduce the present-law bias in favor of taxpayers who manage their business activities from outside their home, thereby enabling more taxpayers to work efficiently at home, save commuting time and expenses, and spend additional time with their families. Moreover, the statutory modification is an appropriate response to the computer and information revolution, which has made it more practical for taxpayers to manage trade or business activities from a home office.

The Committee also 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 Provisions

Definition of principal place of business

The bill amends present-law section 280A to specifically provide that a home office qualifies as the "principal place of business" if (1) the office is used by the taxpayer to conduct administrative or management activities of a trade or business and (2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities of the trade or business. As under present law, deductions will be allowed for a home office meeting the above two-part test only if the

---

[47] In response to the Supreme Court's decision in *Soliman*, the IRS revised its "Publication 587, Business Use of Your Home," to more closely follow the comparative analysis used in *Soliman* by focusing on the following two primary factors in determining whether a home office is a taxpayer's principal place of business: (1) the relative importance of the activities performed at each business location; and (2) the amount of time spent at each location.

office is exclusively used on a regular basis as a place of business by the taxpayer, and in the case of an employee, only if such exclusive use is for the convenience of the employer.

Thus, under the bill, a home office deduction will be allowed (subject to the present-law "convenience of the employer" rule governing employees) if a portion of a taxpayer's home is exclusively and regularly used to conduct administrative or management activities for a trade or business of the taxpayer, who does not conduct substantial administrative or management activities at any other fixed location of the trade or business, regardless of whether administrative or management activities connected with his trade or business (e.g., billing activities) are performed by others at other locations. The fact that a taxpayer also carries out administrative or management activities at sites that are not fixed locations of the business, such as a car or hotel room, will not affect the taxpayer's ability to claim a home office deduction under the provision. Moreover, if a taxpayer conducts some administrative or management activities at a fixed location of the business outside the home, the taxpayer still will be eligible to claim a deduction so long as the administrative or management activities conducted at any fixed location of the business outside the home are not substantial (e.g., the taxpayer occasionally does minimal paperwork at another fixed location of the business). In addition, a taxpayer's eligibility to claim a home office deduction under the provision will not be affected by the fact that the taxpayer conducts substantial *non-administrative* or *non-management* business activities at a fixed location of the business outside the home (e.g., meeting with, or providing services to, customers, clients, or patients at a fixed location of the business away from home).

If a taxpayer *in fact* does not perform substantial administrative or management activities at any fixed location of the business away from home, then the second prong of the provision is satisfied, regardless of whether or not the taxpayer opted not to use an office away from home that was available for the conduct of such activities. However, in the case of an employee, the question whether an employee *opted* not to use suitable space made available by the employer for administrative activities is relevant to determining whether the present-law "convenience of the employer" test is satisfied (see footnote 46 *supra*). In cases where a taxpayer's use of a home office does not satisfy the provision's two-part test, the taxpayer nonetheless may be able to claim a home office deduction under the present-law "principal place of business" exception or any other provision of section 280A.

Treatment of storage of product samples

In addition, 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 provisions apply to taxable years beginning after December 31, 1995.

TITLE IV. FAMILY REINFORCEMENT

A. Tax Credit for Adoption Expenses (sec. 401 of the bill and new sec. 25 of the Code)

Present Law

Present law does not provide a tax credit for adoption expenses. The Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap), could not reasonably be expected to be adopted unless adoption assistance is provided. Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State-funded programs. The maximum Federal reimbursement is $1,000 per special needs child. Reimbursable expenses include those nonrecurring costs directly associated with the adoption process such as legal costs, social service review, and transportation costs. [48]

Reasons for Change

The Committee believes that the financial costs of the adoption process should not be a barrier to adoptions. The Committee wishes to encourage further the adoption of special needs children therefore a tax credit is allowed in addition to any grant money received for the adoption expenses associated with the adoption of special needs children.

Explanation of Provision

The bill provides taxpayers with a maximum credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to, and the principal purpose of which, are the legal adoption of an eligible child. An eligible child is an individual (1) who has not attained age 18 as of the time of the adoption, or (2) who is physically or mentally incapable of caring for himself or herself. No credit is al-

[48] H.R. 1157 ("Welfare Transformation Act of 1995"), as reported by the House Committee on Ways and Means, would replace the Federal Adoption Assistance Program with a block grant to the States (H. Rept. 104–81, March 15, 1995).

lowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, or (3) in connection with the adoption of a child of the taxpayer's spouse. The credit is phased out ratably for taxpayers with adjusted gross income (AGI) above $60,000 and is fully phased out at $100,000 of AGI. For purposes of this AGI test, the taxpayer's AGI is increased by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U. S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands, and residents of Puerto Rico, respectively).

The $5,000 limit is a per child not an annual limitation. For example, if a taxpayer incurs $3,000 of qualified adoption expenses in year one and $3,000 of qualified adoption expenses in year two, then the taxpayer will receive a $3,000 credit in year one and a $2,000 credit in year two. Further, the credit is not limited to successful adoptions so the taxpayer in the above example will receive the credit regardless of whether the adoption is completed.

To avoid a double benefit, the bill denies the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or deduction. Also, except in the case of special needs children, the credit is not allowed for any expenses for which a grant is received under any Federal, State, or local program. A special needs child is a child who the State has determined: (1) cannot or should not be returned to the home of the parents, and (2) has a specific factor or condition because of which the child cannot be placed with adoptive parents without adoption assistance. Examples of factors or conditions are the child's ethnic background, age, membership in a minority or sibling group, medical conditions, or physical, mental, or emotional handicaps.

The bill provides that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from their spouse for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Finally, the bill provides that an individual legally separated from his spouse under a decree of divorce or separate maintenance is not considered married for purposes of this provision.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

B. Tax Credit for Custodial Care of Certain Elderly Family Members in Taxpayer's Home (sec. 402 of the bill and new sec. 25B of the Code)

Present Law

Generally, present law does not provide for tax credits based solely on custodial care of parents or grandparents. However, taxpayers with dependent parents generally are able to claim a personal exemption for these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,500 for 1995, and is adjusted annually for inflation. The amount of the personal exemption is phased out for taxpayers with AGI in excess of $114,700 for single taxpayers, $143,350 for heads of household, and $172,050 for married couples filing joint returns.

Reasons for Change

The Committee believes that it is appropriate to provide some relief to families providing for elderly and incapacitated family members. Further, the Committee believes that the provision will encourage homecare rather than institutionalization of these family members.

Explanation of Provision

The bill provides taxpayers who maintain a household including one or more "qualified persons" with a maximum credit against income tax liability of $500 for each qualified person.

To be a "qualified person," an individual has to satisfy: (1) a relationship test, (2) a residency test, (3) a disability test, and (4) an identification test. The individual satisfies the relationship test if the individual is the father or mother of: (a) the taxpayer, (b) the taxpayer's spouse, or (c) a former spouse of the taxpayer. A stepfather, stepmother, and ancestors of the father or mother are treated as a father or mother for these purposes.

An individual satisfies the residency test if the individual has the same principal place of abode as the taxpayer for more than one-half of the taxpayer's taxable year.

An individual satisfies the disability test if the individual is physically or mentally incapable of caring for himself or herself. This disability test should operate in the same manner as the disability test in section 21 of the Code (the credit based on expenses for household and dependent care services necessary for gainful employment).

An individual satisfies the identification test if the individual's name and taxpayer identification number (TIN) are included on the taxpayer's return for the taxable year.

The bill provides that an individual is treated as maintaining a household for any period only if over one-half of the cost of maintaining a household for such period is furnished by such individual or, if such individual is married, by such individual and his or her spouse. The bill also provides that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart from their spouse for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the qualified person for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Finally, the bill provides that an individual legally separated from his or her spouse under a decree of divorce or of separate maintenance is not considered married for purposes of this provision.

Effective Date

The provision is effective for taxable years beginning after December 31, 1995.

TITLE V. INCREASE IN THE SOCIAL SECURITY EARNINGS LIMIT (sec. 501 of the bill)

Present Law

Under present law, senior citizens age 70 and older receive full Social Security benefits regardless of the amount of earnings they have from wages or self employment. Senior citizens between age 65 and 69 are eligible for full benefits only if their earnings are lower than the earnings limit amount determined by law. In 1995, the annual earnings limit for those age 65 to 69 is $11,280. The earnings limit amount is indexed and increases annually in proportion to the rate of average wage growth in the economy.

Calendar year	*Earnings limit Present law*
1996	$11,640
1997	11,880
1998	12,240
1999	12,720
2000	13,200

Senior citizens age 65 to 69 who earn more than the earnings limit lose $1 in Social Security benefits for every $3 in wages or self employment income they earn over the limit.

The substantial gainful activity (SGA) amount applicable to individuals who are eligible for Social Security disability benefits on the basis of blindness is currently linked to the monthly earnings limit exempt amount for those age 65 to 69. The 1995 monthly amount is $940, wage-indexed in the future. For individuals eligible for Social Security disability based on severe disabilities other than blindness, the SGA amount is $500 per month and is not wage-indexed.

Reasons for Change

The current earnings limit has been shown to act as a disincentive to skilled older workers, who would otherwise choose to remain productively employed. In particular, the earnings limit imposes a hardship on middle and lower-income retirees, who often rely on earnings from work to supplement their Social Security benefits. These middle and lower income retirees often have little or no other income, such as pensions or investments, to supplemental their Social Security benefits.

Given the combined effects of Federal, State and local income taxes, Social Security payroll tax, tax on benefits, and the earnings limit, senior citizens who earn even moderate amounts over the earnings limit can be subjected to extremely high marginal tax rates, rates far greater than those paid by younger workers with incomes at the same level.

Raising the earnings limit would also ease the administrative burdens of the Social Security Administration (SSA), which spends over $200 million a year to monitor and update the earnings limit. SSA estimates that 60 percent of all overpayments, and 45 percent of all underpayments, result from the earnings limit.

Explanation of Provision

The bill will gradually raise the earnings limit for those age 65 to 69 to $30,000 by the year 2000. The increase will be phased in over 5 years as follows:

Calendar Year	*Earnings limit Under the bill*
1996	15,000
1997	19,000
1998	23,000
1999	27,000
2000	30,000

After 2000, the exempt amount will be increased automatically based on increases in average wages.

Senior citizens age 65 to 69 who earn over the given earnings limit for the year will continue to lose $1 in benefits for every $3 earned over the limit.

The substantial gainful activity (SGA) amount applicable to individuals who are eligible for Social Security disability benefits on the basis of blindness will no longer be linked to the earnings limit exempt amount for those age 65 to 69. As under present law, the SGA amount for blind individuals will continue to be wage-indexed in the future.

Effective Date

The provision applies to taxable years beginning after 1995.

TITLE VI. TAX TECHNICAL CORRECTIONS

The technical corrections title 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. 602(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. 602(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. 602(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. 602(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. 602(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 recordkeeping 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 noncompliance 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."[49] The legislative history of the 1990 Act, which added section 6038C to the Code, uses the same language.[50]

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.

---

[49] 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).

[50] "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. 602(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. 602(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. 602(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. 602(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 is generally 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[51] 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.

---

[51] 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.[52] 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 would also 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.

[52] With respect to gifts made in 1990, 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 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. 602(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. 602(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. 602(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 credit (sec. 602(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. 602(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 restoring the prior-law depreciation treatment of certain energy property (sec. 168(e)(3)(B)(vi)); (2) a provision restoring the prior-law definition of property eligible for expensing (sec. 179(d)); and (3) 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. 603(b) 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. 603(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.[53] 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.

[53] 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. 603(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. 603(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 of 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 either 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. 603(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. 603(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. 603(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[54] 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-

[54] 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,[55] 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. 603(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. 603(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

---

[55] 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. 603(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. 603(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. 604(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. 604(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.[56] 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.

[56] 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. 604(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. 604(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).[57] 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 ac-

[57] See S. Rept. 99–313, p. 725.

tivity 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. 604(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.[58] 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.[59]

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"). [60]

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). [61]

---

[58] 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).

[59] 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."

[60] See Rev. Rul. 81–303, 1981–2 C. B. 255.

[61] 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).

The Technical and Miscellaneous Revenue Act of 1988 ("1988 Act") increased the unified credit allowed an estate of a non-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 non-resident 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 containing pro rata exemptions, because in those treaties taxation follows situs. 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. 604(f)(2) 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. [62]

In order for the earnings stripping provision to apply to a corporation for a taxable year, two thresholds must be exceeded. To 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

[62] 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.)

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 carryover 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. Branch-level interest tax (sec. 604(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.[63] 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 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.

[63] Staff of the Joint Committee on Taxation, 100th Cong., 1st Sess., *"General Explanation of the Tax Reform Act of 1986,"* at 1036 (1987).

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.

8. Determination of source in case of sales of inventory property (sec. 604(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.

9. Repeal of obsolete provisions (sec. 604(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.

10. Clarification of certain stadium bond transition rule in Tax Reform Act of 1986 (sec. 604(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.

11. Health care continuation rules (sec. 604(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.

12. Taxation of excess inclusions of a residual interest in a REMIC for taxpayers subject to alternative minimum tax with net operating losses (sec. 604(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 a rate of 24 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. Under the alternative tax net operating loss deduction, a taxpayer may deduct ninety percent of its net operating loss carryovers against alternative minimum taxable income.

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.

13. Application of harbor maintenance tax to Alaska and Hawaii ship passengers (sec. 604(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).

14. Modify effective date provision relating to the Energy Policy Act of 1992 (sec. 604(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 liability (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.

15. Treat qualified football coaches plan as multiemployer pension plan for purposes of the Internal Revenue Code (sec. 604(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).

16. Determination of unrecovered investment in annuity contract (sec. 604(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.

17. Election by parent to claim unearned income of certain children on parent's return (sec. 604(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 exemption 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, 1994.

18. Exclusion from income for combat zone compensation (sec. 604(o)(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.

III. VOTES OF THE COMMITTEE

In compliance with clause 2(l)(2)(B) of rule XI of the Rules of the House of Representatives, the following statements are made concerning the votes of the Committee in its consideration of the bill, H.R. 1215.

Motion to Report the Bill

The bill, H.R. 1215, was ordered favorably reported without amendment on March 14, 1995, by a roll call vote of 21 yeas and 14 nays (with a quorum being present). The vote was as follows:

YEAS	NAYS
Mr. Archer	Mr. Gibbons
Mr. Crane	Mr. Rangel
Mr. Thomas	Mr. Stark
Mr. Shaw	Mr. Jacobs
Mrs. Johnson	Mr. Ford
Mr. Bunning	Mr. Matsui
Mr. Houghton	Mrs. Kennelly
Mr. Herger	Mr. Coyne
Mr. McCrery	Mr. Levin
Mr. Hancock	Mr. Cardin
Mr. Camp	Mr. McDermott
Mr. Ramstad	Mr. Kleczka
Mr. Zimmer	Mr. Lewis
Mr. Nussle	Mr. Payne
Mr. Johnson	
Ms. Dunn	
Mr. Collins	
Mr. Portman	
Mr. English	
Mr. Ensign	
Mr. Christensen	

Vote on Amendment

The Committee defeated an amendment (14 yeas and 21 nays) offered by Mr. McDermott to sunset all provisions of the bill on and after January 1, 2001. The roll call vote was as follows:

YEAS	NAYS
Mr. Gibbons	Mr. Archer
Mr. Rangel	Mr. Crane
Mr. Stark	Mr. Thomas
Mr. Jacobs	Mr. Shaw
Mr. Ford	Mrs. Johnson
Mr. Matsui	Mr. Bunning
Mrs. Kennelly	Mr. Houghton
Mr. Coyne	Mr. Herger

Mr. Levin	Mr. McCrery
Mr. Cardin	Mr. Hancock
Mr. McDermott	Mr. Camp
Mr. Kleczka	Mr. Ramstad
Mr. Lewis	Mr. Zimmer
Mr. Payne	Mr. Nussle
	Mr. Johnson
	Ms. Dunn
	Mr. Collins
	Mr. Portman
	Mr. English
	Mr. Ensign
	Mr. Christensen

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimate 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 effects on the budget of this bill, H.R. 1215, as reported.

The bill is estimated to have the following effects on budget receipts and outlays for fiscal years 1995–2000:

ESTIMATED BUDGET EFFECTS OF THE PROVISIONS RELATING TO H.R. 1215, THE ''CONTRACT WITH AMERICA TAX RELIEF ACT OF 1995''

[By fiscal years, in billions of dollars]

Provision	Effective	1995	1996	1997	1998	1999	2000	1995–00
Title I. American Dream Restoration:								
A. Family Tax Credit ($500 in 1996, and thereafter; children under age 18; phase-out $200,000 to $250,000).	1/1/96	....	−4.6	−23.3	−24.1	−26.2	−26.7	−104.9
B. Credit to Reduce the Marriage Penalty	tyba DoE	....	−0.2	−2.0	−2.0	−2.0	−2.0	−8.2
C. Establishment of American Dream Savings Accounts and Spousal IRAs:								
1. American Dream Savings Accounts	1/1/96	....	1.2	1.6	1.0	0.2	−2.0	2.0
2. $2,000 Spousal IRA	1/1/96	....	(1)	−0.1	−0.1	−0.1	−0.1	−0.5
Total, title I		....	−3.7	−23.8	−25.2	−28.1	−30.9	−111.6
Title II. Senior Citizens' Equity:								
A. Repeal of Increase in Tax on Social Security Benefits (phase-in 75%, 65%, 60%, 55%, 50%)	1/1/96	....	−0.5	−1.9	−3.2	−4.3	−5.6	−15.6
B. Treatment of Long-Term Care Insurance	1/1/96	....	−0.9	−1.0	−1.2	−1.4	−1.6	−6.1
C. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts	1/1/96	....	(1)	−0.1	−0.1	−0.2	−0.2	−0.6
Total, title II		....	−1.4	−3.0	−4.5	−5.9	−7.4	−22.3
Title III. Job Creation and Wage Enhancement:								
A. Capital Gains Reforms: Provisions in ''Contract'' but (a) indexing is not allowed to create losses; (b) no indexing and max rate of 25% for corporations; (c) collectibles—choice of indexing or 28% max rate; (d) holding period for indexing of 3 years; (e) indexing applies only to assets acquired after 1994, but with an election to mark-to-market for 1995; (f) net lease exclusion removed; and (g) other miscellaneous changes.	1/1/95	0.3	11.3	−5.2	−10.4	−13.0	−14.9	−31.9
B. Leasehold Improvements Provision	lida 3/13/95	(1)	(1)	(1)	(1)	(1)	(1)	(2)
C. Neutral Cost Recovery	ppisa 12/31/94	1.2	9.2	10.0	6.3	−1.2	−8.8	16.7
D. Corporate Alternative Minimum Tax (AMT) Reform: Prospective repeal of corporate AMT and business preferences under the individual AMT; Full repeal of the corporate AMT beginning in 2001.	generally 1/1/95 [3]	−0.8	−2.7	−3.6	−3.3	−3.7	−2.7	−16.9
E. Interaction Between Neutral Cost Recovery (C.) and Corporate AMT (D.) Provisions [4]		0.4	0.7	0.7	0.4	0.1	(5)	2.3
F. Debt Reduction Checkoff and Trust Fund	tyba DoE	(9)	(9)	(9)	(9)	(9)	(9)	(9)
G. Small Business Incentives:								
1. Increase in unified estate and gift tax credits [6]	1/1/96	....	....	−1.4	−1.6	−1.8	−2.1	−6.8
2. Increase in expense treatment for small businesses ($22,500 for 1996, $27,500 for 1997, $32,500 for 1998, and $35,000 for 1999 and thereafter).	tyba 12/31/95	....	−0.6	−1.4	−2.0	−2.1	−1.8	−7.8

3. Clarification of definition of principal place of business; Treatment of storage of product samples.	1/1/96		−0.1	−0.2	−0.2	−0.2	−0.2	−0.9
Total, title III		1.1	17.8	−1.1	−10.8	−21.9	−30.5	−45.3
Title IV. Family Reinforcement:								
A. Credit for Adoption Expenses	tyba 12/31/95		(1)	−0.2	−0.2	−0.2	−0.2	−1.0
B. Credit for Custodial Care of Certain Elderly Dependents in Taxpayer's Home	tyba 12/31/95		−0.1	−0.2	−0.2	−0.2	−0.2	−1.0
Total, title IV			−0.1	−0.4	−0.4	−0.4	−0.4	−2.0
Title V. Social Security Provisions:								
A. Modify Social Security Earnings Limitations [7]	1/1/96		−0.5	−1.1	−1.6	−2.1	−2.4	−7.6
Total, title V			−0.5	−1.1	−1.6	−2.1	−2.4	−7.6
Title VI. Technical Corrections:								
A. Technical Corrections Provisions		(5)						(5)
Total, title, VI		(5)						(5)
Total, revenue provisions (titles I, II, III, IV, VI) [8]		1.1	12.6	−28.3	−40.9	−56.4	−69.2	−181.2
Grand total (all titles) [8]		1.1	12.1	−29.4	−42.5	−58.5	−71.6	−188.8

[1] Loss of less than $50 million.
[2] Loss of less than $100 million.
[3] The Alternative Minimum Tax depreciation adjustment would be repealed for: (1) all property covered under the Neutral Cost Recovery System; and (2) all other depreciable property placed in service after March 13, 1995.
[4] The positive interaction between these two provisions will go to zero if either of these provisions is removed from the package.
[5] Gain of less than $50 million.
[6] Beginning after 1998, estimate includes indexing of the following: (1) the $10,000 annual exclusions for gifts; (2) the $750,000 ceiling amount on special use valuation under section 2032A of the Internal Revenue Code; (3) the $1,000,000 generation-skipping transfer tax exemption; and (4) the value of closely held business eligible for the special four-percent interest rate under section 6601(j) of the Internal Revenue Code.
[7] Change in outlays supplied by the Congressional Budget Office.
[8] Total does not include all possible interaction among provisions.
[9] No revenue effect.

Legend for ''Effective'' column: tyba DoE=taxable years beginning after date of enactment; ppisa=property placed in service after; tyba=taxable years beginning after; lida=leasehold improvements disposed of after.

Note.—Details may not add to totals due to rounding.

Source: Joint Committee on Taxation.

B. 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 outlay for the increase in the limit on Social Security earnings involves increased budget authority (amounts shown in the revenue table in IV.A., above).

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 revenue-reducing income tax provisions (other than the provision relating to the definition of principal place of business and treatment of storage of product samples) of the bill involve increased tax expenditures, and that the revenue-increasing income tax provisions involve reduced tax expenditures. (See specific amounts in the revenue table in IV.A., above.) The increase in the unified estate and gift tax credits is not treated as a tax expenditure, since under the Budget Act estate and gift tax changes are not considered as tax expenditures.

C. Cost Estimate of the Congressional Budget Office

In compliance with subdivision (C) of clause 2(l)(3) of rule XI of the Rules of the House of Representatives (requiring a cost estimate by the Congressional Budget Office), the following statement from the Congressional Budget Office is provided.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, March 16, 1995.

Hon. BILL ARCHER,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1215, the Contract With America Tax Relief Act of 1995, as ordered reported by the House Committee on Ways and Means on March 14, 1995.

The bill would affect direct spending and receipts and thus would be subject to pay-as-you-go procedures under section 252 of the Balanced Budget and Emergency Deficit Control Act of 1985.

If you wish further details on this estimate, we will be pleased to provide them.

Sincerely,

JUNE E. O'NEILL, *Director.*

Enclosure.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

1. Bill number: H.R. 1215.
2. Bill title: Contract With America Tax Relief Act of 1995.
3. Bill status: As ordered reported by the Committee on Ways and Means on March 14, 1995.

4. Bill purpose: The bill would provide for a family tax credit, establish American dream savings accounts, repeal a portion of the income tax on Social Security benefits, reduce the taxation of capital gains and index them for inflation, change depreciation rules, and make other changes in the Internal Revenue Code. It would also increase the exempt amount for the Social Security earnings test and establish a Public Debt Reduction Trust Fund.

5. Estimated cost to the Federal Government:

Direct spending

The bill would increase Social Security benefit payments, which are off-budget. The following table shows projected Social Security benefits under current law, the changes that would stem from the bill, and projected benefit payments if the bill were enacted.

SOCIAL SECURITY BENEFITS (OFF-BUDGET)

[Outlays by fiscal years, in billions of dollars]

	1995	1996	1997	1998	1999	2000
Projected Spending Under Current Law	329.7	347.5	366.5	386.5	407.7	430.3
Proposed Changes	0	0.5	1.1	1.6	2.1	2.4
Projected Spending under H.R. 1215	329.7	347.9	367.6	388.1	409.7	432.7

Note.—Numbers may not add to totals due to rounding.

The effects of this provision fall within budget function 650.

The bill would also phase out the increase in the taxation of Social Security benefits that was enacted in 1993. During the phase-out period, the part of the increase that remained would be allocated to the Social Security trust funds rather than to the Hospital Insurance trust fund. This reallocation would appear in the budget as a decrease in offsetting receipts (increase in net outlays) of the Hospital Insurance trust fund (which is on-budget) and a corresponding increase in the receipts (decrease in the net outlays) of the Social Security trust funds (which are off-budget). The following table shows these changes.

[Outlays by fiscal years, in billions of dollars]

	1995	1996	1997	1998	1999	2000
Off-Budget	0	−2.4	−2.4	−1.7	−1.0	−0.2
On-Budget	0	2.4	2.4	1.7	1.0	0.2
Total	0	0	0	0	0	0

The effects of this provision fall within budget functions 570 and 650.

Revenues

The bill would affect on-budget federal revenues. The following table shows projected revenues under current law, the changes that would stem from the bill, and projected revenues if the bill were enacted.

[Revenues by fiscal years, in billions of dollars]

	1995	1996	1997	1998	1999	2000
Projected revenues under current law	1,355.2	1,417.7	1,475.5	1,546.4	1,618.3	1,697.5

[Revenues by fiscal years, in billions of dollars]

	1995	1996	1997	1998	1999	2000
Proposed changes (on-budget)	1.1	12.6	−28.3	−40.9	−56.4	−69.2
Projected revenues under H.R. 1215	1,356.3	1,430.3	1,447.2	1,505.5	1,561.9	1,628.3

6. Basis of estimate:

Direct spending

Social Security Earnings Test. Title V of H.R. 1215 would relax the current limitations on the receipt of Social Security benefits for those aged 65–69 with earnings above a certain level. Under current law, individuals entitled to Social Security cash benefits may have their benefits reduced, or withheld completely, if their earnings exceed a specified exempt amount.

In 1995, the law provides that Social Security beneficiaries under age 65 may earn up to $8,160 a year in wages or self-employment income without having their benefits affected. Those aged 65–69 can earn up to $11,280. The earnings test currently reduces benefits for those under age 65 by $1 for each $2 of earnings above the exempt amount. Those aged 65–69 lose $1 in benefits for each $3 of earnings above the exempt amount. The test does not apply to recipients over age 69. (A different and more stringent earnings restriction applies to recipients of Disability Insurance (DI) benefits and would be unaffected by proposed changes in the earnings test.) The exempt amounts rise each year at the same rate as average wages in the economy.

Title V of H.R. 1215 would affect beneficiaries who have reached the normal retirement age, currently 65. Under this bill, the annual exempt amount for beneficiaries aged 65–69 would be increased in stages during 1996–2000 to $30,000 in 2000. The exempt amount would be increased automatically thereafter based on the increase in average wages. The ad hoc increases in the exempt amount under the bill are compared in the following table with the exempt amounts that are estimated to occur under current law.

Calendar year	Current law	H.R. 1215
1995	$11,280	$11,280
1996	11,640	15,000
1997	11,880	19,000
1998	12,240	23,000
1999	12,720	27,000
2000	13,200	30,000

The legislation is estimated to increase outlays by $458 million in 1996 rising to $2.415 billion in the year 2000. According to the Social Security Administration, in 1996 an estimated 720,000 Social Security beneficiaries would receive additional benefits under the proposal. In 2000, when the proposal would be fully phased in, roughly 800,000 beneficiaries would be so affected.

Raising the earnings test exempt amount could result in behavioral responses that lead to an increase in earnings of those 65 and over, but empirical research suggests that the response is likely to be relatively small. Although the proposed increase in the earnings test is larger than past increases, two considerations reinforce this conclusion. First, Social Security beneficiaries who have already reduced their hours of work on account of the earnings test may not be inclined to increase their work effort or may find limited opportunities to do so. Therefore, any increase in work effort may be largely confined to newly eligible beneficiaries. Second, two scheduled changes in Social Security will reduce the impact of changing the earnings test. The increase in the normal retirement age for workers who reach age 62 in 2000 and thereafter will reduce the number of years during which the proposed increases in the exempt amount will apply. Also, the amount of the delayed retirement credit is being gradually increased, so that in 2005 and thereafter the expected amount of the credit will fully offset the amount of benefits withheld on account of the earnings test.

Public Debt Reduction Trust Fund. Subtitle D of H.R. 1215 would establish a public debt reduction checkoff and trust fund. Enactment of this provision would have no effect on either revenues or outlays. The proposal would permit individual taxpayers to dedicate up to 10 percent of income tax liability into a "Public Debt Reduction Trust Fund" by means of a checkoff on their tax returns. The checkoff would neither increase nor decrease the amount of taxes paid by the taxpayer. Furthermore, the amount dedicated to the trust fund would have no effect on current law spending obligations of the federal government and would not directly constrain future appropriations or direct spending legislation. Because expected deficits would not change as a result of enactment of Subtitle D, the total amount of debt issued and redeemed would not be affected.

Revenues

The revenue estimates were prepared by the Joint Committee on Taxation (see attached table). For information on the estimating assumptions, see Joint Committee on Taxation, "Analysis of Estimated Effects on Fiscal Year Budget Receipts of the Revenue Provisions in the Contract With America" (JCX–4–95), February 6, 1995, and Joint Committee on Taxation, "Description of the Contract With America Tax Relief Act of 1995" (JCX–9–95), March 9, 1995.

7. Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act of 1985 sets up pay-as-you-go procedures for legislation affecting direct spending or receipts through 1998. Changes in Social Security are excluded from the pay-as-you-go calculations. The pay-as-you-go effects of the bill are as follows.

[By fiscal years, in billions of dollars]

	1995	1996	1997	1998
Outlays	0	2.4	2.4	1.7
Receipts	1.1	12.6	−28.3	−40.9

8. Estimated cost to State and local governments: H.R. 1215 mandates no new or additional spending by state and local governments. Tax receipts could be affected in states whose income taxes are tied to provisions of the federal income tax.

9. Estimate comparison: None.

10. Previous CBO estimate: None.

11. Estimate prepared by: Wayne Boyington (Social Security) Daniel Kowalski (Debt Reduction Trust Fund) Richard Kasten (Payments to OASDI and HI Trust Funds)

12. Estimate approved by: Paul N. Van de Water, Assistant Director for Budget Analysis.

V. OTHER MATTERS TO BE DISCUSSED UNDER THE 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 as a result of the Committee's oversight activities concerning the taxation of the family, taxation of savings and investment, capital cost recovery, the alternative minimum tax, the tax treatment of leasehold improvements, taxation of social security benefits, the tax treatment of long-term care insurance and accelerated death benefits under life insurance contracts, the unified estate and gift tax credits, expensing deduction for small business, the tax treatment of home office expenses and storage of product samples, the debt reduction checkoff and trust fund, increase in Social Security earnings limit, and technical corrections to recent tax legislation that the Committee concluded it is appropriate to enact the provisions contained in the bill as reported. (See also Parts I.B and I.C of this report for a discussion of the background and purpose of the bill and the legislative history and hearings held on the provisions included in the bill.)

B. 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 this 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 makes the following statement concerning the possible inflationary impact of the bill.

The estimated revenue reductions in the bill as reported (see Part IV.A of this report) are expected to be fully offset by spending reductions in other legislation to be considered by the House of Representatives along with the provisions of this bill (H.R. 1215). Thus, the combined tax reduction provisions of this bill and the expected spending reduction legislation are projected to not result in an increase in the overall Federal deficit or an overall inflationary impact on prices in the operation of the nation's economy.

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

* * * * * * *

SECTION 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

* * * * * * *

[(h) MAXIMUM CAPITAL GAINS RATE.—If a taxpayer has a net capital gain for any taxable year, then the tax imposed by this section shall not exceed the sum of—

[(1) a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

[(A) taxable income reduced by the amount of the net capital gain, or

[(B) the amount of taxable income taxed at a rate below 28 percent, plus

[(2) a tax of 28 percent of the amount of taxable income in excess of the amount determined under paragraph (1).

[For purposes of the preceding sentence, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer elects to take into account as investment income for the taxable year under section 163(d)(4)(B)(iii).]

PART IV—CREDITS AGAINST TAX

* * * * * * *

Subpart A—Nonrefundable Personal Credits

* * * * * * *

SEC. 23. FAMILY TAX CREDIT.

(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to $500 multiplied by the number of qualifying children of the taxpayer.

(b) LIMITATION.—The amount of credit which would (but for this subsection) be allowed by subsection (a) shall be reduced (but not

below zero) by an amount which bears the same ratio to such amount of credit as—

(1) the excess (if any) of the taxpayer's adjusted gross income (determined without regard to sections 911, 931, and 933) over $200,000, bears to

(2) an amount equal to 100 times the dollar amount in effect under subsection (a) for the taxable year.

(c) QUALIFYING CHILD.—For purposes of this section—

(1) IN GENERAL.—The term "qualifying child" means any individual if—

(A) the taxpayer is allowed a deduction under section 151 with respect to such individual for such taxable year,

(B) such individual has not attained the age of 18 as of the close of the calendar year in which the taxable year of the taxpayer begins, and

(C) such individual bears a relationship to the taxpayer described in section 32(c)(3)(B) (determined without regard to clause (ii) thereof).

(2) EXCEPTION FOR CERTAIN NONCITIZENS.—The term "qualifying child" shall not include any individual who would not be a dependent if the first sentence of section 152(b)(3) were applied without regard to all that follows "resident of the United States".

(d) INFLATION ADJUSTMENTS.—

(1) IN GENERAL.—In the case of a taxable year beginning in a calendar year after 1996, the $500 and $200,000 amounts contained in subsections (a) and (b) shall each be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting "calendar year 1995" for "calendar year 1992" in subparagraph (B) thereof.

(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $50, such amount shall be rounded to the nearest multiple of $50.

(e) CERTAIN OTHER RULES APPLY.—Rules similar to the rules of subsections (d) and (e) of section 32 shall apply for purposes of this section.

SEC. 24. CREDIT TO REDUCE MARRIAGE PENALTY.

(a) ALLOWANCE OF CREDIT.—In the case of a joint return for the taxable year, there shall be allowed as a credit against the tax imposed by this chapter for such taxable year an amount equal to the marriage penalty reduction credit.

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The amount of credit allowed by subsection (a) for the taxable year shall not exceed $145.

(2) CREDIT DISALLOWED FOR INDIVIDUALS CLAIMING SECTION 911, ETC.—No credit shall be allowed under this section for any taxable year if either spouse claims the benefits of section 911, 931, or 933 for such taxable year.

(c) MARRIAGE PENALTY REDUCTION CREDIT.—For purposes of this section—

(1) IN GENERAL.—The marriage penalty reduction credit is an amount equal to the excess (if any) of—

(A) the joint tax amount of the taxpayer, over

(B) the sum of the unmarried tax amounts for each spouse.

(2) UNMARRIED TAX AMOUNT.—For purposes of paragraph (1), the unmarried tax amount, with respect to an individual, is the amount of tax which would be imposed by section 1(c) if such individual's taxable income were equal to the excess (if any) of—

(A) such individual's qualified earned income for the taxable year, over

(B) the sum of—

(i) an amount equal to the basic standard deduction under section 63(c)(2)(C) for the taxable year, plus

(ii) the exemption amount (as defined in section 151(d)) for such taxable year.

(3) JOINT TAX AMOUNT.—For purposes of paragraph (1), the joint tax amount is the amount of tax which would be imposed by section 1(a) if the taxpayer's taxable income were equal to the excess (if any) of—

(A) the taxpayer's qualified earned income for the taxable year, over

(B) the sum of—

(i) an amount equal to the basic standard deduction under section 63(c)(2)(A) for the taxable year, plus

(ii) an amount equal to twice the exemption amount (as so defined) for such taxable year.

(d) QUALIFIED EARNED INCOME.—For purposes of this section—

(1) IN GENERAL.—The term "qualified earned income" means an amount equal to the excess (if any) of—

(A) the earned income for the taxable year, over

(B) an amount equal to the sum of the deductions described in paragraphs (1), (2), (6), (7), and (12) of section 62(a) to the extent that such deductions are properly allocable to or chargeable against earned income for such taxable year.

The amount of qualified earned income shall be determined without regard to any community property laws.

(2) EARNED INCOME.—For purposes of paragraph (1)—

(A) IN GENERAL.—The term "earned income" means income which is earned income within the meaning of section 401(c)(2)(C) or 911(d)(2) (determined without regard to the phrase "not in excess of 30 percent of his share of the net profits of such trade or business" in subparagraph (B) thereof).

(B) EXCEPTION.—Such term shall not include any amount—

(i) not includible in gross income,

(ii) received as a pension or annuity,

(iii) paid or distributed out of an individual retirement plan (within the meaning of section 7701(a)(37)),

(iv) received as deferred compensation, or

(v) received for services performed by an individual in the employ of the spouse (within the meaning of section 3121(b)(3)(A)).

(e) AMOUNT OF CREDIT TO BE DETERMINED UNDER TABLES.—

(1) IN GENERAL.—The amount of the credit allowed by this section shall be determined under tables prescribed by the Secretary.

(2) REQUIREMENTS FOR TABLES.—The tables prescribed under paragraph (1) shall reflect the provisions of subsection (c) and shall round to the nearest $25 any amount of credit which is less than the maximum credit under subsection (b)(1).

SEC. 25A. ADOPTION EXPENSES.

(a) ALLOWANCE OF CREDIT.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year the amount of the qualified adoption expenses paid or incurred by the taxpayer during such taxable year.

(b) LIMITATIONS.—

(1) DOLLAR LIMITATION.—The aggregate amount of qualified adoption expenses which may be taken into account under subsection (a) with respect to the adoption of a child shall not exceed $5,000.

(2) INCOME LIMITATION.—The amount allowable as a credit under subsection (a) for any taxable year shall be reduced (but not below zero) by an amount which bears the same ratio to the amount so allowable (determined without regard to this paragraph but with regard to paragraph (1)) as—

(A) the amount (if any) by which the taxpayer's adjusted gross income (determined without regard to sections 911, 931, and 933) exceeds $60,000, bears to

(B) $40,000.

(3) DENIAL OF DOUBLE BENEFIT.—

(A) IN GENERAL.—No credit shall be allowed under subsection (a) for any expense for which a deduction or credit is allowable under any other provision of this chapter.

(B) GRANTS.—No credit shall be allowed under subsection (a) for any expense to the extent that funds for such expense are received under any Federal, State, or local program. The preceding sentence shall not apply to expenses for the adoption of a child with special needs.

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

(1) QUALIFIED ADOPTION EXPENSES.—

(A) IN GENERAL.—The term "qualified adoption expenses" means reasonable and necessary adoption fees, court costs, attorney fees, and other expenses—

(i) which are directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer, and

(ii) which are not incurred in violation of State or Federal law or in carrying out any surrogate parenting arrangement.

(B) EXPENSES FOR ADOPTION OF SPOUSE'S CHILD NOT ELIGIBLE.—The term "qualified adoption expenses" shall not include any expenses in connection with the adoption by an

individual of a child who is the child of such individual's spouse.

(2) ELIGIBLE CHILD.—The term "eligible child" means any individual—

(A) who has not attained age 18 as of the time of the adoption, or

(B) who is physically or mentally incapable of caring for himself.

(3) CHILD WITH SPECIAL NEEDS.—The term "child with special needs" means any child if—

(A) a State has determined that the child cannot or should not be returned to the home of his parents, and

(B) such State has determined that there exists with respect to the child a specific factor or condition (such as his ethnic background, age, or membership in a minority or sibling group, or the presence of factors such as medical conditions or physical, mental, or emotional handicaps) because of which it is reasonable to conclude that such child cannot be placed with adoptive parents without providing adoption assistance.

(d) MARRIED COUPLES MUST FILE JOINT RETURNS, ETC.—Rules similar to the rules of paragraphs (2), (3), and (4) of section 21(e) shall apply for purposes of this section.

SEC. 25B. CREDIT FOR TAXPAYERS WITH CERTAIN PERSONS REQUIRING CUSTODIAL CARE IN THEIR HOUSEHOLDS.

(a) ALLOWANCE OF CREDIT.—In the case of an individual who maintains a household which includes as a member one or more qualified persons, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to $500 for each such person.

(b) QUALIFIED PERSON.—For purposes of this section, the term "qualified person" means any individual—

(1) who is a father or mother of the taxpayer, his spouse, or his former spouse or who is an ancestor of such a father or mother,

(2) who is physically or mentally incapable of caring for himself,

(3) who has as his principal place of abode for more than half of the taxable year the home of the taxpayer, and

(4) whose name and TIN are included on the taxpayer's return for the taxable year.

For purposes of paragraph (1), a stepfather or stepmother shall be treated as a father or mother.

(c) SPECIAL RULES.—For purposes of this section, rules similar to the rules of paragraphs (1), (2), (3), and (4) of section 21(e) shall apply.

Subpart B—Foreign Tax Credit, Etc.

* * * * * * *

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.

* * * * * * *

Subpart D—Business related Credits

* * * * * * *

SEC. 38. GENERAL BUSINESS CREDIT.

(a) * * *

* * * * * * *

(c) LIMITATION BASED ON AMOUNT OF TAX.—

(1) * * *

(2) SPECIAL RULES.—

(A) * * *

* * * * * * *

(C) LIMITATIONS WITH RESPECT TO CERTAIN PERSONS.—In the case of a person described in subparagraph (A) or (B) of section 46(e)(1) (as in effect on the day before the date of the enactment of the Revenue Reconciliation Act of 1990), the $25,000 amount specified under subparagraph (B) of paragraph (1) shall equal such person's ratable share (as determined under section 46(e)(2) (as so in effect) of such amount *and without regard to the deduction under section 56(h)*.

* * * * * * *

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 enactment of this sentence)).

* * * * * * *

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 G—Credit Against Regular Tax for Prior Year Minimum Tax Liability

* * * * * * *

SEC. 53. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.

(a) * * *

* * * * * * *

⟦(c) LIMITATION.—The credit allowable under subsection (a) for any taxable year shall not exceed the excess (if any) of—

⟦(1) the regular tax liability of the taxpayer for such taxable year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part, over

⟦(2) the tentative minimum tax for the taxable year.⟧

(c) LIMITATION.—The credit allowable under subsection (a) for any taxable year shall not exceed the lesser of—

(1) the excess (if any) of—

(A) the regular tax liability of the taxpayer for such taxable year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part, over

(B) the tentative minimum tax for the taxable year, or

(2) 90 percent of the amount determined under paragraph (1)(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 allowed 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 TAX

*   *   *   *   *   *   *

SEC. 55. ALTERNATIVE MINIMUM TAX IMPOSED.

(a) GENERAL RULE.—There is hereby imposed (in addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of—

(1) the tentative minimum tax for the taxable year, over

(2) the regular tax for the taxable year.

In the case of a corporation, the tentative minimum tax for any taxable year beginning after December 31, 2000, shall be zero.

*   *   *   *   *   *   *

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

(a) ADJUSTMENTS APPLICABLE TO ALL TAXPAYERS.—In determining the amount of the alternative minimum taxable income for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) DEPRECIATION.—

(A) IN GENERAL.—

(i) PROPERTY OTHER THAN CERTAIN PERSONAL PROPERTY.—Except as provided in clause (ii), the depreciation deduction allowable under section 167 with respect to any tangible property placed in service after December 31, 1986, *and before March 14, 1995,* shall be determined under the alternative system of section 168(g).

(ii) 150-PERCENT DECLINING BALANCE METHOD FOR CERTAIN PROPERTY.—The method of depreciation used shall be—

(I) the 150 percent declining balance method,

(II) switching to the straight line method for the 1st taxable year for which using the straight line method with respect to the adjusted basis as of the beginning of the year will yield a higher allowance.

The preceding sentence shall not apply to any section 1250 property (as defined in section 1250(c)) or to any other property if the depreciation deduction determined under section 168 with respect to such other property for purposes of the regular tax is determined by using the straight line method.

(B) EXCEPTION FOR CERTAIN PROPERTY.—This paragraph shall not apply to property described in paragraph (1), (2), (3), or (4) of section 168(f).

(C) COORDINATION WITH TRANSITIONAL RULES.—

(i) IN GENERAL.—This paragraph shall not apply to property placed in service after December 31, 1986, to which the amendments made by section 201 of the Tax Reform Act of 1986 do not apply by reason of section 203, 204, or 251(d) of such Act.

(ii) TREATMENT OF CERTAIN PROPERTY PLACED IN SERVICE BEFORE 1987.—This paragraph shall apply to any property to which the amendments made by section 201 of the Tax Reform Act of 1986 apply by reason of an election under section 203(a)(1)(B) of such Act without regard to the requirement of subparagraph (A) that the property be placed in service after December 31, 1986.

(D) NORMALIZATION RULES.—With respect to public utility property described in section 168(i)(10), the Secretary shall prescribe the requirements of a normalization method of accounting for this section.

(E) USE OF NEUTRAL COST RECOVERY RATIO.—This paragraph shall not apply to property to which section 168(k) applies.

(2) MINING EXPLORATION AND DEVELOPMENT COSTS.—

(A) IN GENERAL.—With respect to each mine or other natural deposit (other than an oil, gas, or geothermal well) of the taxpayer, the amount allowable as a deduction under section 616(a) or 617(a) (determined without regard to section 291(b)) in computing the regular tax for costs paid or incurred after December 31, 1986, *and before January 1, 1996,* shall be capitalized and amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

* * * * * * *

(3) TREATMENT OF CERTAIN LONG-TERM CONTRACTS.—In the case of any long-term contract entered into by the taxpayer on or after March 1, 1986, *and before January 1, 1996,* the taxable income from such contract shall be determined under the percentage of completion method of accounting (as modified by section 460(b)). For purposes of the preceding sentence, in the case of a contract described in section 460(e)(1), the percentage of the contract completed shall be determined under section 460(b)(2) by using the simplified procedures for allocation of costs prescribed under section 460(b)(4). The first sentence of this paragraph shall not apply to any home construction contract (as defined in section 460(e)(6)).

* * * * * * *

(5) POLLUTION CONTROL FACILITIES.—In the case of any certified pollution control facility placed in service after December 31, 1986, *and before January 1, 1996,* the deduction allowable

under section 169 (without regard to section 291) shall be determined under the alternative system of section 168(g).

(6) INSTALLMENT SALES OF CERTAIN PROPERTY.—In the case of any disposition after March 1, 1986, *and before January 1, 1996,* of any property described in section 1221(1), income from such disposition shall be determined without regard to the installment method under section 453. This paragraph shall not apply to any disposition with respect to which an election is in effect under section 453(l)(2)(B).

* * * * * * *

(b) ADJUSTMENTS APPLICABLE TO INDIVIDUALS.—In determining the amount of the alternative minimum taxable income of any taxpayer (other than a corporation), the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

(1) * * *

(2) CIRCULATION AND RESEARCH AND EXPERIMENTAL EXPENDITURES.—

(A) IN GENERAL.—The amount allowable as a deduction under section 173 or 174(a) in computing the regular tax for amounts paid or incurred after December 31, 1986, *and before January 1, 1996,* shall be capitalized and—

(i) in the case of circulation expenditures described in section 173, shall be amortized ratably over the 3-year period beginning with the taxable year in which the expenditures were made, or

(ii) in the case of research and experimental expenditures described in section 174(a), shall be amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

* * * * * * *

(c) ADJUSTMENTS APPLICABLE TO CORPORATIONS.—In determining the amount of the alternative minimum taxable income of a corporation, the following treatment shall apply:

(1) ADJUSTMENT FOR ADJUSTED CURRENT EARNINGS.—Alternative minimum taxable income shall be adjusted as provided in subsection (g).

(2) MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.—In the case of a capital construction fund established under section 607 of the Merchant Marine Act, 1936 (46 U.S.C. 1177)—

(A) subparagraphs (A), (B), and (C) of section 7518(c)(1) (and the corresponding provisions of such section 607) shall not apply to—

(i) any amount deposited in such fund after December 31, 1986, *and before January 1, 1996,* or

(ii) any earnings (including gains and losses) after December 31, 1986, *and before January 1, 1996,* on amounts in such fund, and

(B) no reduction in basis shall be made under section 7518(f) (or the corresponding provisions of such section 607) with respect to the withdrawal from the fund of any amount to which subparagraph (A) applies.

[For purposes of this paragraph, any withdrawal of deposits or earnings from the fund shall be treated as allocable first to deposits made before (and earnings received or accrued before) January 1, 1987.]

For purposes of this paragraph, any withdrawal of deposit or earnings from the fund shall be treated as allocable to deposits made, and earnings received or accrued, in the order in which made, received, or accrued.

(3) SPECIAL DEDUCTION FOR CERTAIN ORGANIZATIONS NOT ALLOWED.—The deduction determined under section 833(b) shall not be allowed. *This paragraph shall not apply to any taxable year beginning after December 31, 1995.*

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

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

(A) the amount of such deduction shall not exceed 90 percent *(100 percent in the case of taxable years beginning after December 31, 1995)* of alternate minimum taxable income determined without regard to such deduction, and

(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) DEPRECIATION.—

(i) PROPERTY PLACED IN SERVICE AFTER 1989.—The depreciation deduction with respect to any property placed in service in a taxable year beginning after 1989 shall be determined under the alternative system of section 168(g). The preceding sentence shall not apply to any property placed in service after December 31, 1993, and the depreciation deduction with respect to such property shall be determined under the rules of subsection (a)(1)[(A)].

* * * * * * *

(B) INCLUSION OF ITEMS INCLUDED FOR PURPOSES OF COMPUTING EARNINGS AND PROFITS.—

(i) * * *

* * * * * * *

(iii) TERMINATION.—This subparagraph shall not apply to any taxable year beginning after December 31, 1995.

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

(i) IN GENERAL.—A deduction shall not be allowed for any item if such item would not be deductible for any taxable year for purposes of computing earnings and profits.

(ii) SPECIAL RULE FOR CERTAIN DIVIDENDS.—

(I) * * *

(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.

* * * * * * *

(v) NEUTRAL COST RECOVERY DEDUCTION.—Clause (i) shall not apply to the additional deduction allowable by reason of section 168(k).

(v) TERMINATION.—This subparagraph shall not apply to any taxable year beginning after December 31, 1995.

(D) CERTAIN OTHER EARNINGS AND PROFITS ADJUSTMENTS.—

(i) INTANGIBLE DRILLING COSTS.—The adjustments provided in section 312(n)(2)(A) shall apply in the case of amounts paid or incurred in taxable years beginning after December 31, 1989. In the case of a taxpayer other than an integrated oil company (as defined in section 291(b)(4)), in the case of any oil or gas well, this clause shall not apply in the case of amounts paid or incurred in taxable years beginning after December 31, 1992. *This clause shall not apply to any taxable year beginning after December 31, 1995.*

(ii) CERTAIN AMORTIZATION PROVISIONS NOT TO APPLY.—Sections 173 and 248 shall not apply to expenditures paid or incurred in taxable year beginning after December 31, 1989. *This clause shall not apply to any expenditure paid or incurred after December 31, 1995.*

(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. This clause shall not apply to any adjustment arising in a taxable year beginning after December 31, 1995.*

(iv) INSTALLMENT SALES.—In the case of any installment sale in a taxable year beginning after December 31, 1989, adjusted current earnings shall be computed as if the corporation did not use the installment method. The preceding sentence shall not apply to the applicable percentage (as determined under section 453A) of the gain from any installment sale with respect to which section 453A(a)(1) applies. *This clause shall not apply to any disposition after December 31, 1995.*

(E) DISALLOWANCE OF LOSS ON EXCHANGE OF DEBT POOLS.—No loss shall be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities. *This subparagraph shall not apply to any exchange after December 31, 1995.*

(F) DEPLETION.—

(i) * * *

* * * * * * *

(iii) TERMINATION.—This subparagraph shall not apply to any deduction for depletion for any taxable year beginning after December 31, 1995.

(G) TREATMENT OF CERTAIN OWNERSHIP CHANGES.—If—

(i) there is an ownership change (within the meaning of section 382) after the date of the enactment of the Tax Reform Act of 1986 with respect to any corporation, and

(ii) there is a net unrealized built-in loss (within the meaning of section 382(h)) with respect to such corporation, then the adjusted basis of each asset of such corporation (immediately after the ownership change) shall be its proportionate share (determined on the basis of respective fair market values) of the fair market value of the assets of such corporation (determined under section 382(h)) immediately before the ownership change. *This subparagraph shall not apply to any ownership change after December 31, 1995.*

【(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. 57. ITEMS OF TAX PREFERENCE.

(a) GENERAL RULE.—For purposes of this part, the items of tax preference determined under this section are—

(1) DEPLETION.—With respect to each property (as defined in section 614), the excess of the deduction for depletion allowable under section 611 for the taxable year over the adjusted basis

of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year). Effective with respect to taxable years beginning after December 31, 1992, this paragraph shall not apply to any deduction for depletion computed in accordance with section 613A(c). *This paragraph shall not apply to any taxable year beginning after December 31, 1995.*

(2) INTANGIBLE DRILLING COSTS.—

(A) * * *

* * * * * * *

(F) TERMINATION.—This paragraph shall not apply to any taxable year beginning after December 31, 1995.

(4) RESERVES FOR LOSSES ON BAD DEBTS OF FINANCIAL INSTITUTIONS.—In the case of a financial institution to which section 593 applies, the amount by which the deduction allowable for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allowable had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience. *This paragraph shall not apply to any taxable year beginning after December 31, 1995.*

(5) TAX-EXEMPT INTEREST.—

(A) * * *

* * * * * * *

(D) TERMINATION FOR CORPORATIONS.—In the case of a corporation (other than a corporation referred to in section 56(g)(6)), this paragraph shall not apply to interest accruing for periods after December 31, 1995.

* * * * * * *

SEC. 58. DENIAL OF CERTAIN LOSSES.

(a) * * *

* * * * * * *

(d) TERMINATION.—This section shall not apply to any loss incurred for any taxable year beginning after December 31, 1995.

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 sec-*

tion 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 57(a)(2)(E).

* * * * * * *

(D) TERMINATION.—This paragraph shall not apply to any taxable year beginning after December 31, 1995.

(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).

* * * * * * *

(h) COORDINATION WITH CERTAIN LIMITATIONS.—The limitations of sections 704(d), 465, *469,* and 1366(d) (and such other provisions as may be specified in regulations) shall be applied for purposes of computing the alternative minimum taxable income of the taxpayer for the taxable year with the adjustments of sections 56, 57, and 58.

* * * * * * *

(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(i)(3)(B)⟧ *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

* * * * * * *

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) * * *

* * * * * * *

(16) LONG-TERM CAPITAL GAINS.—The deduction allowed by section 1202.

* * * * * * *

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

* * * * * * *

(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.

* * * * * * *

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

(a) IN GENERAL.—

(1) * * *

(2) ADDITIONAL AMOUNT.—In the case of a taxpayer with respect to whom the amount determined under subsection (b)(1)(A) exceeds the adjusted base amount, the amount included in gross income under this section shall be equal to the lesser of—

(A) the sum of—

(i) 85 percent of such excess, plus

(ii) the lesser of the amount determined under paragraph (1) or an amount equal to one-half of the difference between the adjusted base amount and the base amount of the taxpayer, or

(B) 85 percent of the social security benefits received during the taxable year.

This paragraph shall not apply to any taxable year beginning after December 31, 1999.

(3) PHASEOUT OF ADDITIONAL AMOUNT.—In the case of any taxable year beginning in a calendar year after 1995 and before 2000, paragraph (2) shall be applied by substituting the percentage determined under the following table for "85 percent" each place it appears:

In the case of a taxable year beginning in calendar year:	***The percentage is:***
1996	*75 percent*
1997	*65 percent*
1998	*60 percent*
1999	*55 percent.*

(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) * * *

* * * * * * *

SEC. 91. EXCESS LONG-TERM CARE BENEFITS.

(a) GENERAL RULE.—Notwithstanding any other provision of this title, gross income shall include the amount of excess long-term care benefits received by the taxpayer during the taxable year.

(b) EXCEPTION FOR TERMINALLY ILL INDIVIDUALS.—Subsection (a) shall not apply to any long-term care benefit paid by reason of an insured who is a terminally ill individual (as defined in section 101(g)) as of the date the benefit is received.

(c) EXCESS LONG-TERM CARE BENEFITS.—For purposes of this section—

(1) IN GENERAL.—The term "excess long-term care benefits" means the excess (if any) of—

(A) the value of the long-term care benefits received by the taxpayer during the taxable year, over

(B) the exclusion amount applicable to such benefits.

(2) LONG-TERM CARE BENEFITS.—The term "long-term care benefits" means—

(A) payments and other benefits under long-term care insurance contracts (as defined in section 7702B(b)) to the extent excludable from gross income by reason of section 7702B(a)(2), and

(B) payments which are excludable from gross income by reason of section 101(g).

(3) EXCLUSION AMOUNT.—

(A) IN GENERAL.—In the case of long-term care benefits received by the taxpayer during the taxable year by reason of the taxpayer being a chronically ill individual, the term "exclusion amount" means the aggregate of $200 for each day during such year on which the individual is a chronically ill individual. In the case of individuals who are

married to each other and who are both chronically ill individuals, the preceding sentence shall be applied separately with respect to each spouse.

(B) OTHER TAXPAYERS.—In the case of long-term care benefits received during the taxable year by a taxpayer by reason of another individual being a chronically ill individual, the term "exclusion amount" means so much of such other individual's exclusion amount (for such other individual's taxable year which begins in the calendar year in which the taxpayer's taxable year begins) as is allocated by such other individual to the taxpayer. Such an allocation shall be made at the time and in the manner prescribed by the Secretary; and once made, shall be irrevocable.

(d) CHRONICALLY ILL INDIVIDUAL.—For purposes of this section, the term "chronically ill individual" has the meaning given to such term by section 7702B(c)(2).

(e) INFLATION ADJUSTMENT OF $200 BENEFIT LIMIT.—In the case of a calendar year after 1996, the $200 amount contained in subsection (c)(3)(A) shall be increased at the same time and in the same manner as amounts are increased pursuant to section 213(d)(11).

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

* * * * * * *

SEC. 101. CERTAIN DEATH BENEFITS.

(a) * * *

* * * * * * *

(g) TREATMENT OF CERTAIN ACCELERATED DEATH BENEFITS.—

(1) IN GENERAL.—For purposes of this section, the following amounts shall be treated as an amount paid by reason of the death of an insured:

(A) Any amount received under a life insurance contract on the life of an insured who is a terminally ill individual.

(B) Any amount received under a life insurance contract on the life of an insured who is a chronically ill individual (as defined in section 7702B(c)(2)) but only if such amount is received under a rider or other provision of such contract which is treated as a long-term care insurance contract under section 7702B.

(2) TREATMENT OF VIATICAL SETTLEMENTS.—

(A) IN GENERAL.—In the case of a life insurance contract on the life of an insured described in paragraph (1), if—

(i) any portion of such contract is sold to any viatical settlement provider, or

(ii) any portion of the death benefit is assigned to such a provider,

the amount paid for such sale or assignment shall be treated as an amount paid under the life insurance contract by reason of the death of such insured.

(B) VIATICAL SETTLEMENT PROVIDER.—The term "viatical settlement provider" means any person regularly engaged in the trade or business of purchasing, or taking assignments of, life insurance contracts on the lives of insureds described in paragraph (1) if—

(i) such person is licensed for such purposes in the State in which the insured resides, or

(ii) in the case of an insured who resides in a State not requiring the licensing of such persons for such purposes, such person meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act of the National Association of Insurance Commissioners.

(3) DEFINITIONS.—For purposes of this subsection—

(A) TERMINALLY ILL INDIVIDUAL.—The term "terminally ill individual" means an individual who has been certified by a physician as having an illness or physical condition which can reasonably be expected to result in death in 24 months or less after the date of the certification.

(B) PHYSICIAN.—The term "physician" has the meaning given to such term by section 1861(r)(1) of the Social Security Act (42 U.S.C. 1395x(r)(1)).

(4) EXCEPTION FOR BUSINESS-RELATED POLICIES.—This subsection shall not apply in the case of any amount paid to any taxpayer other than the insured if such taxpayer has an insurable interest with respect to the life of the insured by reason of the insured being a director, officer, or employee of the taxpayer or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

(5) CROSS REFERENCE.—

For inclusion in gross income of excess benefits, see section 91.

* * * * * * *

SEC. 106. CONTRIBUTIONS BY EMPLOYER TO ACCIDENT AND HEALTH PLANS.

[Gross income of an employee does not include employer-provided coverage under an accident or health plan.]

(a) GENERAL RULE.—Except as provided in subsection (b), gross income of an employee does not include employer-provided coverage under an accident or health plan.

(b) INCLUSION OF LONG-TERM CARE BENEFITS PROVIDED THROUGH FLEXIBLE SPENDING ARRANGEMENTS.—

(1) IN GENERAL.—Effective on and after January 1, 1996, gross income of an employee shall include employer-provided coverage for qualified long-term care services (as defined in section 7702B(c)) to the extent that such coverage is provided through a flexible spending or similar arrangement.

(2) FLEXIBLE SPENDING ARRANGEMENT.—For purposes of this subsection, a flexible spending arrangement is a benefit program which provides employees with coverage under which—

(A) specified incurred expenses may be reimbursed (subject to reimbursement maximums and other reasonable conditions), and

(B) the maximum amount of reimbursement which is reasonably available to a participant for such coverage is less than 500 percent of the value of such coverage.

In the case of an insured plan, the maximum amount reasonably available shall be determined on the basis of the underlying coverage.

* * * * * * *

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) ENLISTED PERSONNEL.—Gross income does not include compensation received for active service as a member below the grade of commissioned officer in the Armed Forces of the United States for any month during any part of which such member—

(1) * * *

* * * * * * *

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. 125. CAFETERIA PLANS.

(a) * * *

*   *   *   *   *   *   *

(f) QUALIFIED BENEFITS DEFINED.—For purposes of this section, the term ''qualified benefit'' means any benefit which, with the application of subsection (a), is not includible in the gross income of the employee by reason of an express provision of this chapter (other than section 117, 127, or 132). Such term includes any group term life insurance which is includible in gross income only because it exceeds the dollar limitation of section 79 and such term includes any other benefit permitted under regulations. *Such term shall not include any long-term care insurance contract (as defined in section 7702B(b)).*

*   *   *   *   *   *   *

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

(a) GENERAL RULE.—In the case of an individual who pays qualified higher education expenses during the taxable year, no amount shall be includible in gross income by reason of the redemption during such year of any qualified United States savings bond.

(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.*

*   *   *   *   *   *   *

SEC. 137. DISTRIBUTIONS FROM CERTAIN RETIREMENT PLANS FOR LONG-TERM CARE INSURANCE.

(a) GENERAL RULE.—The amount which would (but for this section) be includible in the gross income of an individual for the taxable year by reason of eligible distributions during the taxable year shall be reduced (but not below zero) by the aggregate premiums paid by such individual during such taxable year for any long-term care insurance contract (as defined in section 7702B(b)) for coverage of such individual or the spouse of such individual.

(b) ELIGIBLE DISTRIBUTION.—For purposes of this section, the term ''eligible distribution'' means any distribution or payment to an individual from—

(1) an individual retirement plan of such individual,

(2) amounts attributable to employer contributions made pursuant to elective deferrals described in subparagraph (A) or (C) of section 402(g)(3) or section 501(c)(18)(D)(iii), or

(3) amounts deferred under section 457(a).

SEC. [137.] *138.* CROSS REFERENCES TO OTHER ACTS.

(a) For exemption of—

(1) * * *

* * * * * * *

PART IV—TAX EXEMPTION 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. 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❳ *which is* not a gross basis tax.

* * * * * * *

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. 165. LOSSES.

(a) * * *

* * * * * * *

(c) LIMITATION ON LOSSES OF INDIVIDUALS.—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; [and]

(3) except as provided in subsection (h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft[.]*; and*

(4) losses arising from the sale or exchange of the principal residence (within the meaning of section 1034) of the taxpayer.

* * * * * * *

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) * * *

* * * * * * *

(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).

* * * * * * *

(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

* * * * * * *

(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

(1) * * *

* * * * * * *

[(8) Treatment of leasehold improvements.—In the case of any building erected (or improvements made) on leased property, if such building or improvement is property to which this section applies, the depreciation deduction shall be determined under the provisions of this section.]

(8) TREATMENT OF LEASEHOLD IMPROVEMENTS.—

(A) IN GENERAL.—In the case of any building erected (or improvements made) on leased property, if such building or improvement is property to which this section applies, the depreciation deduction shall be determined under the provisions of this section.

(B) TREATMENT OF LESSOR IMPROVEMENTS WHICH ARE ABANDONED AT TERMINATION OF LEASE.—An improvement—

(i) which is made by the lessor of leased property for the lessee of such property, and

(ii) which is irrevocably disposed of or abandoned by the lessor at the termination of the lease by such lessee,

shall be treated for purposes of determining gain or loss under this title as disposed of by the lessor when so disposed of or abandoned.

* * * * * * *

(k) DEDUCTION ADJUSTMENT TO ALLOW EQUIVALENT OF EXPENSING FOR CERTAIN PROPERTY PLACED IN SERVICE AFTER DECEMBER 31, 1994.—

(1) IN GENERAL.—In the case of tangible property placed in service after December 31, 1994, the deduction under this section with respect to such property—

(A) shall be determined by substituting "150 percent" for "200 percent" in subsection (b)(1) in the case of property to which the 200 percent declining balance method would otherwise apply, and

(B) for any taxable year after the taxable year during which the property is placed in service shall be—

(i) the amount determined under this section for such taxable year without regard to this subparagraph, multiplied by

(ii) the applicable neutral cost recovery ratio for such taxable year.

(2) APPLICABLE NEUTRAL COST RECOVERY RATIO.—For purposes of paragraph (1)—

(A) IN GENERAL.—The applicable neutral cost recovery ratio for the property for any taxable year is the number determined by—

(i) dividing—

(I) the gross domestic product deflator for the calendar quarter which includes the mid-point of the taxable year, by

(II) the gross domestic product deflator for the calendar quarter which includes the mid-point of the taxable year in which the property was placed in service by the taxpayer, and

(ii) then multiplying the number determined under clause (i) by the number equal to 1.035 to the nth power where "n" is the number of full years (as of the close of the taxable year referred to in clause (i)(I)) after the date such property was placed in service.

The applicable neutral cost recovery ratio shall never be less than 1. The applicable neutral cost recovery ratio shall be rounded to the nearest $^1/_{1000}$.

(B) SPECIAL RULE FOR CERTAIN PROPERTY.—In the case of property described in paragraph (2) or (3) of subsection (b) or in subsection (g), the applicable neutral cost recovery ratio shall be determined without regard to subparagraph (A)(ii).

(3) GROSS DOMESTIC PRODUCT DEFLATOR.—For purposes of paragraph (2), the gross domestic product deflator for any calendar quarter is the implicit price deflator for the gross domestic product for such quarter (as shown in the last revision thereof released by the Secretary of Commerce before the close of the following calendar quarter).

(4) COORDINATION WITH INDEXING OF BASIS FOR PURPOSES OF DETERMINING GAIN.—Section 1022 shall not apply to any property to which this subsection applies.

(5) ELECTION NOT TO HAVE SUBSECTION APPLY.—This subsection shall not apply to any property if the taxpayer elects not to have this subsection apply to such property. Such an election, once made, shall be irrevocable.

(6) CHURNING TRANSACTIONS.—This subsection shall not apply to any property if this section would not apply to such property were—

(A) subsection (f)(5)(A)(ii) applied by substituting "1995" for "1987" and "1994" for "1986", and

(B) subsection (f)(5)(B) not applied.

(7) ADDITIONAL DEDUCTION NOT TO AFFECT BASIS OR RECAPTURE.—The additional amount determined under this section by reason of this subsection shall not be taken into account in determining the adjusted basis of any property or of any interest in a pass-thru entity (as defined in section 1202(e)(2)) which holds such property and shall not be treated as a deduction for depreciation for purposes of sections 1245 and 1250.

* * * * * * *

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

(a) * * *

(b) PERCENTAGE LIMITATIONS.—

(1) INDIVIDUALS.—In the case of an individual, the deduction provided in subsection (a) shall be limited as provided in the succeeding subparagraphs.

(A) * * *

* * * * * * *

(C) Special limitation with respect to contributions described in subparagraph (A) of certain capital gain property

(i) * * *

* * * * * * *

(iv) For purposes of this paragraph, the term "capital gain property" means with respect to any contribution, any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain which would have been long-term capital gain. For purposes of the preceding sentence, any property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset *and section 1222 shall be applied without regard to paragraph (12) thereof (relating to special rule for collectibles).*

* * * * * * *

(e) CERTAIN CONTRIBUTIONS OF ORDINARY INCOME AND CAPITAL GAIN PROPERTY.—

(1) GENERAL RULE.—The amount of any charitable contribution of property otherwise taken into account under this section shall be reduced by the sum of—

(A) the amount of gain which would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution), and

(B) in the case of a charitable contribution—

(i) of tangible personal property, if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under section 501 (or, in the case of a governmental unit, to any purpose or function described in subsection (c)), or

(ii) to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in subsection (b)(1)(E),

【the amount of gain】 *50 percent ($^{25}/_{35}$ in the case of a corporation) of the amount of gain* which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

For purposes of applying this paragraph (other than in the case of gain to which section 617(d)(1), 1245(a), 1250(a), 1252(a) or 1254(a) applies), property which is property used in the trade or business (as defined in section 1231(b)) shall be treated as a capital asset. *For purposes of this paragraph, section 1222 shall be applied with-*

out regard to paragraph (12) thereof (relating to special rule for collectibles).

*   *   *   *   *   *   *

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) * * *

*   *   *   *   *   *   *

(b) NET OPERATING LOSS CARRYBACKS AND CARRYOVERS.—

(1) YEAR 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.

*   *   *   *   *   *   *

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

(1) * * *

⟦(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation—

⟦(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includable on account of gains from sales or exchanges of capital assets; and

⟦(B) the exclusion provided by section 1202 shall not be allowed.⟧

(2) CAPITAL GAINS AND LOSSES.—

(A) LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation, the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets.

(B) DEDUCTION UNDER SECTION 1202.—The deduction under section 1202 shall not be allowed.

*   *   *   *   *   *   *

(4) NONBUSINESS DEDUCTIONS OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) * * *

(B) the modifications specified in paragraphs (1), ⟦(2)(B),⟧ *(2)(B)*, and (3) shall be taken into account;

(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) * * *

* * * * * * *

(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:

If the taxable year begins in:	***The applicable amount is:***
1996	*$22,500*
1997	*27,500*
1998	*32,500*
1999 or thereafter	*35,000.*

* * * * * * *

(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 (as defined in section 1245(a)(3)) property 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 REFUELING 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. 213. MEDICAL, DENTAL, ETC., EXPENSES.

(a) * * *

* * * * * * *

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

(1) The term "medical care" means amounts paid—

(A) for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body,

(B) for transportation primarily for and essential to medical care referred to in subparagraph (A), 【or】

(C) for qualified long-term care services (as defined in section 7702B(c)), or

【(C)】 *(D)* for insurance (including amounts paid as premiums under part B of title XVIII of the Social Security Act, relating to supplementary medical insurance for the aged) covering medical care referred to in 【subparagraphs (A) and (B)】 *subparagraphs (A), (B), and (C).*

In the case of a long-term care insurance contract (as defined in section 7702B(b)), only eligible long-term care premiums (as defined in paragraph (11)) shall be taken into account under subparagraph (D).

* * * * * * *

(6) In the case of an insurance contract under which amounts are payable for other than medical care referred to in 【subparagraphs (A) and (B)】 *subparagraphs (A), (B), and (C)* of paragraph (1)—

(A) no amount shall be treated as paid for insurance to which 【paragraph (1)(C)】 *paragraph (1)(D)* applies unless the charge for such insurance is either separately stated in the contract, or furnished to the policyholder by the insurance company in a separate statement,

* * * * * * *

(7) Subject to the limitations of paragraph (6), premiums paid during the taxable year by a taxpayer before he attains the age of 65 for insurance covering medical care (within the meaning of 【subparagraphs (A) and (B)】 *subparagraphs (A),*

(B), and (C) of paragraph (1)) for the taxpayer, his spouse, or a dependent after the taxpayer attains the age of 65 shall be treated as expenses paid during the taxable year for insurance which constitutes medical care if premiums for such insurance are payable (on a level payment basis) under the contract for a period of 10 years or more or until the year in which the taxpayer attains the age of 65 (but in no case for a period of less than 5 years).

*   *   *   *   *   *   *

(10) CERTAIN PAYMENTS TO RELATIVES TREATED AS NOT PAID FOR MEDICAL CARE.—An amount paid for a qualified long-term care service (as defined in section 7702B(c)) provided to an individual shall be treated as not paid for medical care if such service is provided—

(A) by a relative (directly or through a partnership, corporation, or other entity) unless the relative is a licensed professional with respect to such services, or

(B) by a corporation or partnership which is related (within the meaning of section 267(b) or 707(b)) to the individual.

For purposes of this paragraph, the term "relative" means an individual bearing a relationship to the individual which is described in any of paragraphs (1) through (8) of section 152(a). This paragraph shall not apply for purposes of section 105(b) with respect to reimbursements through insurance.

(11) ELIGIBLE LONG-TERM CARE PREMIUMS.—

(A) IN GENERAL.—For purposes of this section, the term "eligible long-term care premiums" means the amount paid during a taxable year for any long-term care insurance contract (as defined in section 7702B(b)) covering an individual, to the extent such amount does not exceed the limitation determined under the following table:

In the case of an individual with an attained age before the close of the taxable year of:	***The limitation is:***
40 or less	*$200*
More than 40 but not more than 50	*375*
More than 50 but not more than 60	*750*
More than 60 but not more than 70	*2,000*
More than 70	*2,500.*

(B) INDEXING.—

(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 1996, each dollar amount contained in subparagraph (A) shall be increased by the medical care cost adjustment of such amount for such calendar year. If any increase determined under the preceding sentence is not a multiple of $10, such increase shall be rounded to the nearest multiple of $10.

(ii) MEDICAL CARE COST ADJUSTMENT.—For purposes of clause (i), the medical care cost adjustment for any calendar year is the percentage (if any) by which—

(I) the medical care component of the Consumer Price Index (as defined in section 1(f)(5)) for August of the preceding calendar year, exceeds

(II) such component for August of 1995.

The Secretary shall, in consultation with the Secretary of Health and Human Services, prescribe an adjustment which the Secretary determines is more appropriate for purposes of this paragraph than the adjustment described in the preceding sentence, and the adjustment so prescribed shall apply in lieu of the adjustment described in the preceding sentence.

* * * * * * *

SEC. 219. RETIREMENT SAVINGS.

(a) * * *

* * * * * * *

[(c) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—

[(1) IN GENERAL.—In the case of any individual with respect to whom a deduction is otherwise allowable under subsection (a)—

[(A) who files a joint return under section 6013 for a taxable year, and

[(B) whose spouse—

[(i) has no compensation (determined without regard to section 911) for the taxable year, or

[(ii) elects to be treated for purposes of subsection (b)(1)(B) as having no compensation for the taxable year,

there shall be allowed as a deduction any amount paid in cash for the taxable year by or on behalf of the individual to an individual retirement plan established for the benefit of his spouse.

[(2) LIMITATION.—The amount allowable as a deduction under paragraph (1) shall not exceed the excess of—

[(A) the lesser of—

[(i) $2,250, or

[(ii) an amount equal to the compensation includible in the individual's gross income for the taxable year, over

[(B) the amount allowable as a deduction under subsection (a) for the taxable year.

In no event shall the amount allowable as a deduction under paragraph (1) exceed $2,000.]

(c) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—

(1) IN GENERAL.—In the case of an individual to whom this paragraph applies for the taxable year, the limitation of subsection (b)(1) shall be equal to the lesser of—

(A) $2,000, or

(B) the sum of—

(i) the compensation includible in such individual's gross income for the taxable year, plus

(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by the amount allowable as a deduction under subsection (a) to such spouse for such taxable year.

(2) INDIVIDUALS TO WHOM PARAGRAPH (1) APPLIES.—Paragraph (1) shall apply to any individual if—

(A) such individual files a joint return for the taxable year, and

(B) the amount of compensation (if any) includible in such individual's gross income for the taxable year is less than the compensation includible in the gross income of such individual's spouse for the taxable year.

* * * * * * *

(f) OTHER DEFINITIONS AND SPECIAL RULES.—

(1) * * *

(2) MARRIED INDIVIDUALS.—The maximum deduction under [subsections (b) and (c)] *subsection (b)* shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

* * * * * * *

[(7) ELECTION NOT TO DEDUCT CONTRIBUTIONS.—

[For election not to deduct contributions to individual retirement plans, see section 408(o)(2)(B)(ii).]

* * * * * * *

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(b), 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,

* * * * * * *

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,

(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or

(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

In the case of an employee, the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer. *For purposes of subparagraph (A), the term "principal place of business" includes a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or busi-*

ness where the taxpayer conducts substantial administrative or management activities of such trade or business.

(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) DEPRECIATION.—

(A) * * *

(B) DISALLOWED DEDUCTIONS ALLOWED FOR YEARS AFTER RECOVERY PERIOD.—

(i) IN GENERAL.—Except as provided in clause (ii), the unrecovered basis of any passenger automobile shall be treated as an expense for the 1st taxable year after the recovery period. Any excess of the unrecovered basis over the limitation of clause (ii) shall be treated as an expense in the succeeding taxable year. *For purposes of this clause, the unrecovered basis of any passenger automobile shall be treated as including the additional amount determined under section 168 by reason of subsection (k) thereof to the extent not allowed as a deduction by reason of this paragraph for any taxable year in the recovery period.*

* * * * * * *

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 B—Effects on Shareholders and Security Holders

* * * * * * *

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.

* * * * * * *

PART V—CARRYOVERS

* * * * * * *

SEC. 382. LIMITATION ON NET OPERATING LOSS CARRYFORWARDS AND CERTAIN BUILT-IN LOSSES FOLLOWING OWNERSHIP CHANGE.

(a) * * *

* * * * * * *

(h) SPECIAL RULES FOR BUILT-IN GAINS AND LOSSES AND SECTION 338 GAINS.—For purposes of this section—

(1) * * *

(2) RECOGNIZED BUILT-IN GAIN AND LOSS.—

(A) * * *

(B) RECOGNIZED BUILT-IN LOSS.—The term "recognized built-in loss" means any loss recognized during the recognition period on the disposition of any asset except to the extent the new loss corporation establishes that—

(i) such asset was not held by the old loss corporation immediately before the change date, or

(ii) such loss exceeds the excess of—

(I) the adjusted basis of such asset on the change date, over

(II) the fair market value of such asset on such date.

Such term includes any amount allowable as depreciation, amortization, or depletion for any period within the recognition period except to the extent the new loss corporation establishes that the amount so allowable is not attributable to the excess described in clause (ii). *The amount of the net unrealized built-in loss shall be increased by the amount of the additional deduction allowable by reason of section 168(k) which is treated under the preceding sentence as a recognized built-in loss.*

* * * * * * *

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) * * *

* * * * * * *

(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] *section 521* of the Unemployment Compensation Amendments of 1992) shall apply.

* * * * * * *

(k) CASH OR DEFERRED ARRANGEMENTS.—

(1) * * *

(2) QUALIFIED CASH OR DEFERRED ARRANGEMENT.—A qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of subsection (a)—

(A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

(B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election—

(i) may not be distributable to participants or other beneficiaries earlier than—

(I) separation from service, death, or disability,

(II) an event described in paragraph (10),

(III) in the case of a profit-sharing or stock bonus plan, the attainment of age 59½, [or]

(IV) in the case of contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, upon hardship of the employee, [and] *or*

(V) the date distributions for premiums for a long-term care insurance contract (as defined in section 7702B(b)) for coverage of such individual or the spouse of such individual are made, and

* * * * * * *

SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

(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)⟧ *subsection (e)(3)* (determined without regard to this subsection),

* * * * * * *

SEC. 403. TAXATION OF EMPLOYEE ANNUITIES.

(a) * * *

(b) TAXABILITY OF BENEFICIARY UNDER ANNUITY PURCHASED BY SECTION 501(c)(3) ORGANIZATION OR PUBLIC SCHOOL.—

(1) * * *

* * * * * * *

(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.

(11) REQUIREMENT THAT DISTRIBUTIONS NOT BEGIN BEFORE AGE 59½, SEPARATION FROM SERVICE, DEATH, OR DISABILITY.—This subsection shall not apply to any annuity contract unless under such contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only—

(A) when the employee attains age 59½, separates from service, dies, or becomes disabled (within the meaning of section 72(m)(7)), ⟦or⟧

(B) in the case of hardship⟦.⟧, *or*

(C) for the payment of premiums for a long-term care insurance contract (as defined in section 7702B(b)) for coverage of the employee or the spouse of the employee.

Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship.

* * * * * * *

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.

* * * * * * *

SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

(a) * * *

* * * * * * *

(o) DEFINITIONS AND RULES RELATING TO NONDEDUCTIBLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT PLANS.—

(1) * * *

* * * * * * *

(5) TERMINATION.—This subsection shall not apply to any designated nondeductible contribution for any taxable year beginning after December 31, 1995.

* * * * * * *

SEC. 408A. AMERICAN DREAM SAVINGS ACCOUNTS.

(a) GENERAL RULE.—Except as provided in this section, an American Dream Savings Account shall be treated for purposes of this title in the same manner as an individual retirement plan.

(b) AMERICAN DREAM SAVINGS ACCOUNT.—For purposes of this title, the term "American Dream Savings Account" or "ADS account" means an individual retirement plan which is designated at the time of the establishment of the plan as an American Dream Savings Account. Such designation shall be made in such manner as the Secretary may prescribe.

(c) CONTRIBUTION RULES.—

(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to an ADS account.

(2) CONTRIBUTION LIMIT.—

(A) IN GENERAL.—The aggregate amount of contributions (other than rollover contributions) for any taxable year to all ADS accounts maintained for the benefit of an individual shall not exceed the lesser of—

(i) $2,000, or

(ii) an amount equal to the compensation includible in the individual's gross income for such taxable year.

(B) $4,000 LIMITATION FOR CERTAIN ADDITIONAL MARRIED INDIVIDUALS.—

(i) IN GENERAL.—In the case of an individual to whom this subparagraph applies for the taxable year, the limitation of subparagraph (A)(ii) shall be equal to the sum of—

(I) the compensation includible in such individual's gross income for the taxable year, plus

(II) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by the amount of the limitation under subparagraph (A) applicable to such spouse for such taxable year.

(ii) INDIVIDUALS TO WHOM CLAUSE (i) APPLIES.—Clause (i) shall apply to any individual if—

(I) such individual files a joint return for the taxable year, and

(II) the amount of compensation (if any) includible in such individual's gross income for the taxable year is less than the compensation includible in the gross income of such individual's spouse for the taxable year.

(C) ADJUSTMENT FOR INFLATION.—

(i) IN GENERAL.—In the case of a taxable year beginning in a calendar year after 1996, the $2,000 amount 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 1995" for "calendar year 1992" in subparagraph (B) thereof.

(ii) ROUNDING.—If any amount as adjusted under clause (i) is not a multiple of $50, such amount shall be rounded to the nearest multiple of $50.

(D) TAX ON EXCESS CONTRIBUTIONS.—Section 4973 shall be applied separately with respect to individual retirement plans which are ADS accounts and individual retirement plans which are not ADS accounts; except that, for purposes of applying such section with respect to individual retirement plans which are ADS accounts, excess contributions shall be considered to be any amounts in excess of the limitation under subsection (c)(2)(A).

(3) CONTRIBUTIONS PERMITTED AFTER AGE 70½.—Contributions to an ADS account may be made even after the individual for whom the account is maintained has attained age 70½.

(4) MANDATORY DISTRIBUTION RULES NOT TO APPLY, ETC.—

(A) IN GENERAL.—Except as provided in subparagraph (B), subsections (a)(6) and (b)(3) of section 408 (relating to required distributions) and section 4974 (relating to excise tax on certain accumulations in qualified retirement plans) shall not apply to any ADS account.

(B) POST-DEATH DISTRIBUTIONS.—Rules similar to the rules of section 401(a)(9) (other than subparagraph (A) thereof) shall apply for purposes of this section.

(5) LIMITATIONS ON ROLLOVER CONTRIBUTIONS.—No rollover contribution may be made to an ADS account unless—

(A) such contribution is from another ADS account, or

(B) such contribution is from an individual retirement plan (other than an ADS account) and is made before January 1, 1998.

(d) DISTRIBUTION RULES.—For purposes of this title—

(1) GENERAL RULES.—

(A) EXCLUSION FROM GROSS INCOME.—No portion of a qualified distribution from an ADS account shall be includible in gross income.

(B) EXCEPTION FROM PENALTY TAX.—Section 72(t) shall not apply to—

(i) any qualified distribution from an ADS account, and

(ii) any qualified special purpose distribution (whether or not a qualified distribution) from an ADS account.

(2) QUALIFIED DISTRIBUTION.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified distribution" means any payment or distribution—

(i) made on or after the date on which the individual attains age 59½,

(ii) made to a beneficiary (or to the estate of the individual) on or after the death of the individual,

(iii) attributable to the individual's being disabled (within the meaning of section 72(m)(7)), or

(iv) which is a qualified special purpose distribution.

(B) DISTRIBUTIONS WITHIN 5 YEARS.—No payment or distribution shall be treated as a qualified distribution if—

(i) it is made within the 5-taxable year period beginning with the 1st taxable year for which the individual made a contribution to an ADS account (or such individual's spouse made a contribution to an ADS account) established for such individual, or

(ii) in the case of a payment or distribution properly allocable to a rollover contribution (or income allocable thereto), it is made within 5 years after the date on which such rollover contribution was made, as determined under regulations prescribed by the Secretary.

Clause (ii) shall not apply to a rollover contribution from an ADS account.

(3) INCOME INCLUSION FOR ROLLOVERS FROM NON-ADS ACCOUNTS.—In the case of any amount paid or distributed out of an individual retirement plan (other than an ADS account) which is paid into an ADS account (established for the benefit of the payee or distributee, as the case may be) before the close of the 60th day after the day on which the payment or distribution is received—

(A) sections 72(t) and 408(d)(3) shall not apply, and

(B) any amount required to be included in gross income by reason of this paragraph shall be so included ratably over the 4-taxable year period beginning with the taxable year in which the payment or distribution is made.

(e) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—

(1) IN GENERAL.—For purposes of this section, the term "qualified special purpose distribution" means any payments or distributions from an ADS account to the individual for whose benefit such account is established—

(A) if such payments or distributions are qualified first-time homebuyer distributions, or

(B) to the extent such payments or distributions do not exceed—

(i) the qualified higher education expenses of the taxpayer for the taxable year in which received, and

(ii) the qualified medical expenses of the taxpayer for the taxable year in which received.

(2) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—

(A) IN GENERAL.—For purposes of this subsection, the term "qualified first-time homebuyer distribution" means any payment or distribution received by an individual to the extent such payment or distribution is used by the individual before the close of the 60th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence for such individual as a first-time homebuyer.

(B) QUALIFIED ACQUISITION COSTS.—For purposes of this paragraph, the term "qualified acquisition costs" means the costs of acquiring, constructing, or reconstructing a residence. Such term includes any usual or reasonable settlement, financing, or other closing costs.

(C) FIRST-TIME HOMEBUYER; OTHER DEFINITIONS.—For purposes of this paragraph—

(i) FIRST-TIME HOMEBUYER.—The term "first-time homebuyer" means any individual if such individual (and, if married, such individual's spouse) had no present ownership interest in a principal residence during the 3-year period ending on the date of acquisition of the principal residence to which this paragraph applies.

(ii) PRINCIPAL RESIDENCE.—The term "principal residence" has the same meaning as when used in section 1034.

(iii) DATE OF ACQUISITION.—The term "date of acquisition" means the date—

(I) on which a binding contract to acquire the principal residence to which subparagraph (A) applies is entered into, or

(II) on which a binding contract to construct or reconstruct such a principal residence is entered into.

(D) SPECIAL RULE WHERE DELAY IN ACQUISITION.—If any payment or distribution out of an ADS account fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase, construction, or reconstruction of the residence, the amount of the payment or distribution may be contributed to an ADS account as provided in subsection (d)(3)(A)(i) of section 408 (determined by substituting "120th day" for "60th day" in such subsection), except that—

(i) subsection (d)(3)(B) of such section shall not be applied to such contribution, and

(ii) such amount shall not be taken into account in determining whether subsection (d)(3)(A)(i) of such section applies to any other amount.

(3) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of—

(i) the taxpayer,

(ii) the taxpayer's spouse, or

(iii) the taxpayer's child (as defined in section 151(c)(3)) or grandchild,

at an eligible educational institution (as defined in section 135(c)(3)).

(B) COORDINATION WITH SAVINGS BOND PROVISIONS.—The amount of qualified higher education expenses for any taxable year shall be reduced by any amount excludable from gross income under section 135.

(4) QUALIFIED MEDICAL EXPENSES.—

(A) IN GENERAL.—For purposes of this subsection, the term "qualified medical expenses" means any amounts paid during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in section 213(d)) of the taxpayer, his spouse, or a dependent (as defined in section 152).

(B) LONG-TERM CARE INSURANCE PREMIUMS TREATED AS MEDICAL EXPENSES.—For purposes of subparagraph (A), section 213(d)(1)(C) shall not apply but the term "qualified medical expenses" shall include premiums for long-term care insurance (as defined in section 7702B(b)) for coverage of the taxpayer or his spouse.

(f) OTHER DEFINITIONS.—For purposes of this section—

(1) ROLLOVER CONTRIBUTIONS.—The term "rollover contributions" means contributions described in section 402(c), 403(a)(4), 403(b)(8), or 408(d)(3).

(2) COMPENSATION.—The term "compensation" has the meaning given such term by section 219(f).

* * * * * * *

Subpart B—Special Rules

* * * * * * *

SEC. 415. LIMITATIONS ON BENEFITS AND CONTRIBUTION UNDER QUALIFIED PLANS.

(a) * * *

* * * * * * *

(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.

* * * * * * *

Subpart D—Treatment of Welfare Benefits 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 ⟦SEVERENCE⟧ *SEVERANCE* PAY BENEFITS.—

(A) * * *

* * * * * * *

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. 453A. SPECIAL RULES FOR NONDEALERS.

(a) * * *

* * * * * * *

(c) INTEREST ON DEFERRED TAX LIABILITY.—

(1) * * *

* * * * * * *

(3) DEFERRED TAX LIABILITY.—For purposes of this section, the term "deferred tax liability" means, with respect to any taxable year, the product of—

(A) the amount of gain with respect to an obligation which has not been recognized as of the close of such taxable year, multiplied by

(B) the maximum rate of tax in effect under section 1 or 11, whichever is appropriate, for such taxable year.

For purposes of applying the preceding sentence with respect to so much of the gain which, when recognized, will be treated as long-term capital gain, ❲the maximum rate on net capital gain under section 1(h) or 1201 (whichever is appropriate) shall be taken into account.❳ *the maximum rate on net capital* *gain under section 1201 or the deduction under section 1202 (whichever is appropriate) shall be taken into account.*

* * * * * * *

SEC. 457. DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) * * *

* * * * * * *

(d) DISTRIBUTION REQUIREMENTS.—

(1) IN GENERAL.—For purposes of subsection (b)(5), a plan meets the distribution requirements of this subsection if—

(A) under the plan amounts will not be made available to participants or beneficiaries earlier than—

(i) the calendar year in which the participant attains age 70½,

(ii) when the participant is separated from service with the employer, ⟦or⟧

(iii) when the participant is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary in regulations), ⟦and⟧ *or*

(iv) the date distributions for premiums for a long-term care insurance contract (as defined in section 7702B(b)) for coverage of such individual or the spouse of such individual are made, and

* * * * * * *

SEC. 460. SPECIAL RULES FOR LONG-TERM CONTRACTS.

(a) * * *

(b) PERCENTAGE OF COMPLETION METHOD.—

(1) REQUIREMENTS OF PERCENTAGE OF COMPLETION METHOD.—Except as provided in paragraph (3), in the case of any long-term contract with respect to which the percentage of completion method is used—

(A) the percentage of completion shall be determined by comparing costs allocated to the contract under subsection (c) and incurred before the close of the taxable year with the estimated total contract costs, and

(B) upon completion of the contract (or, with respect to any amount properly taken into account after completion of the contract, when such amount is so properly taken into account), the taxpayer shall pay (or shall be entitled to receive) interest computed under the look-back method of paragraph (2).

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 income for the taxable year following the taxable year in which the contract was completed. For purposes of subtitle F (other than sections 6654 and 6655) any interest required to be paid by the taxpayer under subparagraph (B) shall be treated as an increase in the tax imposed by this chapter for the taxable year in which the contract is completed (or, in the case of interest payable with respect to any amount properly taken into account after completion of the contract, for the taxable year in which the amount is so properly taken into account).

* * * * * * *

(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)] *section 168(e)(2)(A)(ii)*), and".

* * * * * * *

Subpart C—Taxable Year for Which Deduction 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. 465. DEDUCTIONS LIMITED TO AMOUNT AT RISK.

(a) LIMITATION TO AMOUNT AT RISK.—

(1) * * *

* * * * * * *

(4) TREATMENT OF NEUTRAL COST RECOVERY DEDUCTION.—

(A) IN GENERAL.—None of the additional deduction allowable by reason of section 168(k) for the taxable year shall be disallowed under paragraph (1) unless there is a disallowed non-NCR loss for such year.

(B) PROPORTIONATE DISALLOWANCE.—

(i) IN GENERAL.—If there is a disallowed non-NCR loss for the taxable year, only the disallowed portion of the additional deduction allowable by reason of section 168(k) shall be not allowed under paragraph (1).

(ii) DISALLOWED PORTION.—For purposes of clause (i), the disallowed portion is the percentage which the

disallowed non-NCR loss's allocable share of non-NCR depreciation is of total non-NCR depreciation.

(iii) ALLOCABLE SHARE.—For purposes of clause (ii), a disallowed non-NCR loss's allocable share of non-NCR depreciation is the amount which bears the same ratio to the amount of the loss as the amount of non-NCR depreciation for the taxable year bears to the total amount of deductions for such taxable year.

(C) DEFINITIONS.—For purposes of this paragraph—

(i) DISALLOWED NON-NCR LOSS.—The term "disallowed non-NCR loss" means, for any taxable year, the amount of the loss from the activity which would be disallowed under paragraph (1) if such loss were determined without regard to the additional deduction allowable by reason of section 168(k).

(ii) NON-NCR DEPRECIATION.—The term "non-NCR depreciation" means the amount allowable as a deduction under section 168 without regard to subsection (k) thereof.

* * * * * * *

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 activity. *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) public debt securities of the United States,

(II) obligations of a State or local government which are not in default as to principal or interest, and

(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)] *section 101(7)* of the Federal Credit Union Act, 12 U.S.C. [1752(6)] *1752(7)*) located in the United States.

* * * * * * *

Subchapter G—Corporations Used to Avoid Income Tax on Shareholders

PART I—CORPORATION 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)] *section 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)] *section 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)[,].

* * * * * * *

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

* * * * * * *

Subchapter J—Estates, Trusts, Beneficiaries, and Decedents

PART I—ESTATES, TRUSTS, AND BENEFICIARIES

Subpart A—General Rules for Taxation of Estates and Trusts

* * * * * * *

SEC. 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

(a) * * *

* * * * * * *

(c) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

(1) * * *

* * * * * * *

[(4) ADJUSTMENTS.—To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain described in section 1202(a), proper adjustment shall be made for any exclusion allowable to the estate or trust under section 1202. In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income).]

(4) ADJUSTMENTS.—To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain from the sale or exchange of capital assets held for more than

1 year, proper adjustment shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income).

* * * * * * *

(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 2621(a)(2)⟧ *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).

* * * * * * *

SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) DISTRIBUTABLE NET INCOME.—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) * * *

* * * * * * *

(3) CAPITAL GAINS AND LOSSES.—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The exclusion under section 1202 shall not be taken into account. *The deduction under section 1202 (relating to deduction of excess of capital gains over capital losses) shall not be taken into account.*

* * * * * * *

(6) INCOME OF FOREIGN TRUST.—In the case of a foreign trust—

(A) * * *

* * * * * * *

(C) Paragraph (3) shall not apply to a foreign trust. In the case of such a trust, *(i)* there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, *and (ii) the deduction under section 1202 (relating to capital gains deduction) shall not be taken into account*.

If the estate or trust is allowed a deduction under section 642(c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642(c) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

* * * * * * *

PART II—INCOME IN RESPECT OF DECEDENTS

* * * * * * *

SEC. 691. RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS.

(a) * * *

* * * * * * *

(c) DEDUCTION FOR ESTATE TAX.—

(1) * * *

* * * * * * *

(4) COORDINATION WITH CAPITAL GAIN PROVISIONS.—For purposes of sections ⟦1(h),⟧ 1201, ⟦1202,⟧ *1202*, and 1211, the amount of any gain taken into account with respect to any item described in subsection (a)(1) shall be reduced (but not below zero) by the amount of the deduction allowable under paragraph (1) of this subsection with respect to such item.

* * * * * * *

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) * * *

(B) EXCEPTION FOR STOCK IN C CORPORATION.—【Subparagaph】 *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) IN GENERAL.—The term "tax reserve method" means—

(i) * * *

* * * * * * *

(iii) NONCANCELLABLE ACCIDENT AND HEALTH INSURANCE CONTRACTS.—In the case of any noncancellable accident and health insurance contract *(other than a long-term care insurance contract, as defined in section 7702B(b))*, a 2-year full preliminary term method.

* * * * * * *

(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 [Commissoners'] *Commissioners'* Annuities Reserve Valuation Method prescribed by the National Association of Insurance Commissioners which is in effect on the date of the issuance of the contract.

* * * * * * *

Subpart E—Definitions and Special Rules

* * * * * * *

SEC. 818. OTHER DEFINITIONS AND SPECIAL RULES.

(a) * * *

* * * * * * *

(g) QUALIFIED ACCELERATED DEATH BENEFIT RIDERS TREATED AS LIFE INSURANCE.—For purposes of this part—

(1) IN GENERAL.—Any reference to a life insurance contract shall be treated as including a reference to a qualified accelerated death benefit rider on such contract.

(2) QUALIFIED ACCELERATED DEATH BENEFIT RIDERS.—For purposes of this subsection, the term "qualified accelerated death benefit rider" means any rider on a life insurance contract if the only payments under the rider are payments meeting the requirements of section 101(g).

(3) EXCEPTION FOR LONG-TERM CARE RIDERS.—Paragraph (1) shall not apply to any rider which is treated as a long-term care insurance contract under section 7702B.

* * * * * * *

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) * * *

* * * * * * *

(3) CAPITAL GAINS.—

(A) * * *

* * * * * * *

(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

(i) * * *

*   *   *   *   *   *   *

(iii) The adjusted basis of such shares in the hands of the shareholder shall be increased, with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by [65 percent] *75 percent* of so much of such amounts as equals the amount subject to tax in accordance with section 1201(a).

*   *   *   *   *   *   *

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)] *section 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 Based 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) INCOME NOT CONNECTED WITH UNITED STATES BUSINESS—30 PERCENT TAX.—

(1) * * *

(2) CAPITAL GAINS OF ALIENS PRESENT IN THE UNITED STATES 183 DAYS OR MORE.—In the case of a nonresident alien individual present in the United States for a period or periods aggregating 183 days or more during the taxable year, there is hereby imposed for such year a tax of 30 percent of the amount by which his gains, derived from sources within the United States, from the sale or exchange at any time during such year of capital assets exceed his losses, allocable to sources within

the United States, from the sale or exchange at any time during such year of capital assets. For purposes of this paragraph, gains and losses shall be taken into account only if, and to the extent that, they would be recognized and taken into account if such gains and losses were effectively connected with the conduct of a trade or business within the United States, except that *such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and* such gains and losses shall be determined without regard to section 1202 and such losses shall be determined without the benefits of the capital loss carryover provided in section 1212. Any gain or loss which is taken into account in determining the tax under paragraph (1) or subsection (b) shall not be taken into account in determining the tax under this paragraph. For purposes of the 183-day requirement of this paragraph, a nonresident alien individual not engaged in trade or business within the United States who has not established a taxable year for any prior period shall be treated as having a taxable year which is the calendar year.

(3) TAXATION OF SOCIAL SECURITY BENEFITS.—For purposes of this section and section 1441—

(A) [85 percent] *50 percent* of any social security benefit (as defined in section 86(d)) shall be included in gross income (notwithstanding section 207 of the Social Security Act), and

* * * * * * *

In the case of any taxable year beginning in a calendar year after 1995 and before 2000, subparagraph (A) shall be applied by substituting the percentage determined for such calendar year under section 86(a)(3) for "50 percent". For treatment of certain citizens of possessions of the United States see section 932(c).

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) * * *

(b) TAXABLE INCOME FOR PURPOSE OF COMPUTING LIMITATION.—

(1) * * *

(2) CAPITAL GAINS.—For purposes of this section—

[(A) IN GENERAL.—Taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income.

[(B) SPECIAL RULES WHERE CAPITAL GAIN RATE DIFFERENTIAL.—In the case of any taxable year for which there is a capital gain rate differential—]

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

(i) [in lieu of applying subparagraph (A),] the taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only in an amount equal to foreign source capital gain net income reduced by the rate differential portion of foreign source net capital gain,

* * * * * * *

(B) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, taxable income from sources outside the United States shall include gain from the sale or exchange of capital assets only to the extent of foreign source capital gain net income.

(3) DEFINITIONS.—For purposes of this subsection—

(A) * * *

* * * * * * *

(C) SECTION 1231 GAINS.—The term "gain from the sale or exchange of capital assets" includes any gain so treated under section 1231.

[(D) CAPITAL GAIN RATE DIFFERENTIAL.—There is a capital gain rate differential for any taxable year if—

[(i) in the case of a taxpayer other than a corporation, subsection (h) of section 1 applies to such taxable year, or

[(ii) in the case of a corporation, any rate of tax imposed by section 11, 511, or 831(a) or (b) (whichever applies) exceeds the alternative rate of tax under section 1201(a) (determined without regard to the last sentence of section 11(b)(1)).

[(E) RATE DIFFERENTIAL PORTION.—

[(i) IN GENERAL.—The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as—

[(I) the excess of the highest applicable tax rate over the alternative tax rate, bears to

[(II) the highest applicable tax rate.

[(ii) HIGHEST APPLICABLE TAX RATE.—For purposes of clause (i), the term "highest applicable tax rate" means—

[(I) in the case of a taxpayer other than a corporation, the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) of section 1 (whichever applies), or

[(II) in the case of a corporation, the highest rate of tax specified in section 11(b).

[(iii) ALTERNATIVE TAX RATE.—For purposes of clause (i), the term "alternative tax rate" means—

[(I) in the case of a taxpayer other than a corporation, the alternative rate of tax determined under section 1(j), or

[(II) in the case of a corporation, the alternative rate of tax under section 1201(a).]

(D) RATE DIFFERENTIAL PORTION.—The rate differential portion of foreign source net capital gain, net capital gain, or the excess of net capital gain from sources within the United States over net capital gain, as the case may be, is the same proportion of such amount as the excess of the highest rate of tax specified in section 11(b) over the alternative rate of tax under section 1201(a) bears to the alternative rate of tax under section 1201(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

* * * * * * *

SEC. 907. SPECIAL RULES IN CASE OF FOREIGN OIL AND GAS INCOME.

(a) * * *

* * * * * * *

(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)(I)⟧ *subparagraphs (D)(ii)* and (E)(i) thereof) with respect to the domestic corporation.

* * * * * * *

Subpart F—Controlled Foreign Corporations

* * * * * * *

SEC. 956A. EARNINGS INVESTED IN EXCESS PASSIVE ASSETS.

(a) * * *

(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 referred to in section 316(a)(1) to the extent such amount was accumulated in taxable years beginning after September 30, 1993, and⟧

(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

* * * * * * *

(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) * * *

* * * * * * *

(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.

* * * * * * *

Subchapter O—Gain or Loss on Dispostion 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)] *subsection (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) * * *

* * * * * * *

SEC. 1022. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER DECEMBER 31, 1994, FOR PURPOSES OF DETERMINING GAIN.

(a) GENERAL RULE.—

(1) INDEXED BASIS SUBSTITUTED FOR ADJUSTED BASIS.—Solely for purposes of determining gain on the sale or other disposition by a taxpayer (other than a corporation) of an indexed asset which has been held for more than 3 years, the indexed basis of the asset shall be substituted for its adjusted basis.

(2) EXCEPTION FOR DEPRECIATION, ETC.—The deductions for depreciation, depletion, and amortization shall be determined without regard to the application of paragraph (1) to the taxpayer or any other person.

(b) INDEXED ASSET.—

(1) IN GENERAL.—For purposes of this section, the term "indexed asset" means—

(A) common stock in a C corporation (other than a foreign corporation), and

(B) tangible property,

which is a capital asset or property used in the trade or business (as defined in section 1231(b)).

(2) STOCK IN CERTAIN FOREIGN CORPORATIONS INCLUDED.—For purposes of this section—

(A) IN GENERAL.—The term "indexed asset" includes common stock in a foreign corporation which is regularly traded on an established securities market.

(B) EXCEPTION.—Subparagraph (A) shall not apply to—

(i) stock of a foreign investment company (within the meaning of section 1246(b)),

(ii) stock in a passive foreign investment company (as defined in section 1296),

(iii) stock in a foreign corporation held by a United States person who meets the requirements of section 1248(a)(2), and

(iv) stock in a foreign personal holding company (as defined in section 552).

(C) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS.—An American depository receipt for common stock in a foreign corporation shall be treated as common stock in such corporation.

(c) INDEXED BASIS.—For purposes of this section—

(1) GENERAL RULE.—The indexed basis for any asset is—

(A) the adjusted basis of the asset, increased by

(B) the applicable inflation adjustment.

(2) APPLICABLE INFLATION ADJUSTMENT.—The applicable inflation adjustment for any asset is an amount equal to—

(A) the adjusted basis of the asset, multiplied by

(B) the percentage (if any) by which—

(i) the gross domestic product deflator for the last calendar quarter ending before the asset is disposed of, exceeds

(ii) the gross domestic product deflator for the last calendar quarter ending before the asset was acquired by the taxpayer.

The percentage under subparagraph (B) shall be rounded to the nearest 1⁄10 of 1 percentage point.

(3) GROSS DOMESTIC PRODUCT DEFLATOR.—The gross domestic product deflator for any calendar quarter is the implicit price deflator for the gross domestic product for such quarter (as shown in the last revision thereof released by the Secretary of Commerce before the close of the following calendar quarter).

(d) SUSPENSION OF HOLDING PERIOD WHERE DIMINISHED RISK OF LOSS; TREATMENT OF SHORT SALES.—

(1) IN GENERAL.—If the taxpayer (or a related person) enters into any transaction which substantially reduces the risk of loss from holding any asset, such asset shall not be treated as an indexed asset for the period of such reduced risk.

(2) SHORT SALES.—

(A) IN GENERAL.—In the case of a short sale of an indexed asset with a short sale period in excess of 3 years, for purposes of this title, the amount realized shall be an amount equal to the amount realized (determined without regard to this paragraph) increased by the applicable inflation adjustment. In applying subsection (c)(2) for purposes of the preceding sentence, the date on which the property is sold short shall be treated as the date of acquisition and the closing date for the sale shall be treated as the date of disposition.

(B) SHORT SALE PERIOD.—For purposes of subparagraph (A), the short sale period begins on the day that the property is sold and ends on the closing date for the sale.

(e) TREATMENT OF REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

(1) ADJUSTMENTS AT ENTITY LEVEL.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the adjustment under subsection (a) shall be allowed to any qualified investment entity (including for pur-

poses of determining the earnings and profits of such entity).

(B) EXCEPTION FOR CORPORATE SHAREHOLDERS.—Under regulations—

(i) in the case of a distribution by a qualified investment entity (directly or indirectly) to a corporation—

(I) the determination of whether such distribution is a dividend shall be made without regard to this section, and

(II) the amount treated as gain by reason of the receipt of any capital gain dividend shall be increased by the percentage by which the entity's net capital gain for the taxable year (determined without regard to this section) exceeds the entity's net capital gain for such year determined with regard to this section, and

(ii) there shall be other appropriate adjustments (including deemed distributions) so as to ensure that the benefits of this section are not allowed (directly or indirectly) to corporate shareholders of qualified investment entities.

For purposes of the preceding sentence, any amount includible in gross income under section 852(b)(3)(D) shall be treated as a capital gain dividend and an S corporation shall not be treated as a corporation.

(C) EXCEPTION FOR QUALIFICATION PURPOSES.—This section shall not apply for purposes of sections 851(b) and 856(c).

(D) EXCEPTION FOR CERTAIN TAXES IMPOSED AT ENTITY LEVEL.—

(i) TAX ON FAILURE TO DISTRIBUTE ENTIRE GAIN.—If any amount is subject to tax under section 852(b)(3)(A) for any taxable year, the amount on which tax is imposed under such section shall be increased by the percentage determined under subparagraph (B)(i)(II). A similar rule shall apply in the case of any amount subject to tax under paragraph (2) or (3) of section 857(b) to the extent attributable to the excess of the net capital gain over the deduction for dividends paid determined with reference to capital gain dividends only. The first sentence of this clause shall not apply to so much of the amount subject to tax under section 852(b)(3)(A) as is designated by the company under section 852(b)(3)(D).

(ii) OTHER TAXES.—This section shall not apply for purposes of determining the amount of any tax imposed by paragraph (4), (5), or (6) of section 857(b).

(2) ADJUSTMENTS TO INTERESTS HELD IN ENTITY.—

(A) REGULATED INVESTMENT COMPANIES.—Stock in a regulated investment company (within the meaning of section 851) shall be an indexed asset for any calendar quarter in the same ratio as—

(i) the average of the fair market values of the indexed assets held by such company at the close of each month during such quarter, bears to

(ii) the average of the fair market values of all assets held by such company at the close of each such month.

(B) REAL ESTATE INVESTMENT TRUSTS.—Stock in a real estate investment trust (within the meaning of section 856) shall be an indexed asset for any calendar quarter in the same ratio as—

(i) the fair market value of the indexed assets held by such trust at the close of such quarter, bears to

(ii) the fair market value of all assets held by such trust at the close of such quarter.

(C) RATIO OF 80 PERCENT OR MORE.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 80 percent or more, such ratio for such quarter shall be 100 percent.

(D) RATIO OF 20 PERCENT OR LESS.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 20 percent or less, such ratio for such quarter shall be zero.

(E) LOOK-THRU OF PARTNERSHIPS.—For purposes of this paragraph, a qualified investment entity which holds a partnership interest shall be treated (in lieu of holding a partnership interest) as holding its proportionate share of the assets held by the partnership.

(3) TREATMENT OF RETURN OF CAPITAL DISTRIBUTIONS.—Except as otherwise provided by the Secretary, a distribution with respect to stock in a qualified investment entity which is not a dividend and which results in a reduction in the adjusted basis of such stock shall be treated as allocable to stock acquired by the taxpayer in the order in which such stock was acquired.

(4) QUALIFIED INVESTMENT ENTITY.—For purposes of this subsection, the term "qualified investment entity" means—

(A) a regulated investment company (within the meaning of section 851), and

(B) a real estate investment trust (within the meaning of section 856).

(f) OTHER PASS-THRU ENTITIES.—

(1) PARTNERSHIPS.—

(A) IN GENERAL.—In the case of a partnership, the adjustment made under subsection (a) at the partnership level shall be passed through to the partners.

(B) SPECIAL RULE IN THE CASE OF SECTION 754 ELECTIONS.—In the case of a transfer of an interest in a partnership with respect to which the election provided in section 754 is in effect—

(i) the adjustment under section 743(b)(1) shall, with respect to the transferor partner, be treated as a sale of the partnership assets for purposes of applying this section, and

(ii) with respect to the transferee partner, the partnership's holding period for purposes of this section in such assets shall be treated as beginning on the date of such adjustment.

(2) S CORPORATIONS.—In the case of an S corporation, the adjustment made under subsection (a) at the corporate level shall

be passed through to the shareholders. This section shall not apply for purposes of determining the amount of any tax imposed by section 1374 or 1375.

(3) COMMON TRUST FUNDS.—In the case of a common trust fund, the adjustment made under subsection (a) at the trust level shall be passed through to the participants.

(4) INDEXING ADJUSTMENT DISREGARDED IN DETERMINING LOSS ON SALE OF INTEREST IN ENTITY.—Notwithstanding the preceding provisions of this subsection, for purposes of determining the amount of any loss on a sale or exchange of an interest in a partnership, S corporation, or common trust fund, the adjustment made under subsection (a) shall not be taken into account in determining the adjusted basis of such interest.

(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

(1) IN GENERAL.—This section shall not apply to any sale or other disposition of property between related persons except to the extent that the basis of such property in the hands of the transferee is a substituted basis.

(2) RELATED PERSONS DEFINED.—For purposes of this section, the term "related persons" means—

(A) persons bearing a relationship set forth in section 267(b), and

(B) persons treated as single employer under subsection (b) or (c) of section 414.

(h) TRANSFERS TO INCREASE INDEXING ADJUSTMENT.—If any person transfers cash, debt, or any other property to another person and the principal purpose of such transfer is to secure or increase an adjustment under subsection (a), the Secretary may disallow part or all of such adjustment or increase.

(i) SPECIAL RULES.—For purposes of this section—

(1) TREATMENT OF IMPROVEMENTS, ETC.—If there is an addition to the adjusted basis of any tangible property or of any stock in a corporation during the taxable year by reason of an improvement to such property or a contribution to capital of such corporation—

(A) such addition shall never be taken into account under subsection (c)(1)(A) if the aggregate amount thereof during the taxable year with respect to such property or stock is less than $1,000, and

(B) such addition shall be treated as a separate asset acquired at the close of such taxable year if the aggregate amount thereof during the taxable year with respect to such property or stock is $1,000 or more.

A rule similar to the rule of the preceding sentence shall apply to any other portion of an asset to the extent that separate treatment of such portion is appropriate to carry out the purposes of this section.

(2) ASSETS WHICH ARE NOT INDEXED ASSETS THROUGHOUT HOLDING PERIOD.—The applicable inflation ratio shall be appropriately reduced for periods during which the asset was not an indexed asset.

(3) TREATMENT OF CERTAIN DISTRIBUTIONS.—A distribution with respect to stock in a corporation which is not a dividend shall be treated as a disposition.

(4) ACQUISITION DATE WHERE THERE HAS BEEN PRIOR APPLICATION OF SUBSECTION (a)(1) WITH RESPECT TO THE TAXPAYER.—If there has been a prior application of subsection (a)(1) to an asset while such asset was held by the taxpayer, the date of acquisition of such asset by the taxpayer shall be treated as not earlier than the date of the most recent such prior application.

(5) COLLAPSIBLE CORPORATIONS.—The application of section 341(a) (relating to collapsible corporations) shall be determined without regard to this section.

(j) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

* * * * * * *

PART III—COMMON NONTAXABLE EXCHANGES

* * * * * * *

SEC. 1035. CERTAIN EXCHANGES OF INSURANCE POLICIES.

(a) GENERAL RULES.—No gain or loss shall be recognized on the exchange of—

(1) * * *

* * * * * * *

(3) an annuity contract for an annuity contract**[**.**]***; or*

(4) a contract of life insurance or an endowment or annuity contract for a long-term care insurance contract (as defined in section 7702B(b)).

* * * * * * *

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) PUBLICLY TRADED SECURITIES.—The term "publicly traded securities" means securities which are traded on an established securities market.

[(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.

(d) BASIS ADJUSTMENTS.—If gain from any sale is not recognized by reason of subsection (a), such gain shall be applied to reduce (in the order acquired) the basis for determining gain or loss of any common stock or partnership interest in any specialized small business investment company which is purchased by the taxpayer during the 60-day period described in subsection (a). **[**This subsection shall not apply for purposes of section 1202.**]**

* * * * * * *

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 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.

[(b) CROSS REFERENCES.—

For computation of the alternative tax—

[(1) in the case of life insurance companies, see section 801(a)(2),

[(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

[(3) in the case of real estate investment trusts, see section 857(b)(3)(A).]

SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

(a) GENERAL RULE.—If for any taxable year a corporation has a net capital gain, then, in lieu of the tax imposed by sections 11, 511, and 831(a) and (b) (whichever is applicable), 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 25 percent of the net capital gain.

(b) TRANSITIONAL RULE.—

(1) IN GENERAL.—In the case of any taxable year ending after December 31, 1994, and beginning before January 1, 1996, subsection (a)(2) shall be applied as if it read as follows:

"(2)(A) a tax of 25 percent of the lesser of—

"(i) the net capital gain for the taxable year, or

"(ii) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1994, plus

"(B) a tax of 35 percent of the excess (if any) of—

"(i) the net capital gain for the taxable year, over

"(ii) the amount of net capital gain taken into account under subparagraph (A)."

(2) SPECIAL RULE FOR PASS-THRU ENTITIES.—Section 1202(e)(2) shall apply for purposes of paragraph (1).

(c) CROSS REFERENCES.—

For computation of the alternative tax—

(1) in the case of life insurance companies, see section 801(a)(2),

(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

(3) in the case of real estate investment trusts, see section 857(b)(3)(A).

⟦SEC. 1202. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

⟦(a) 50-PERCENT EXCLUSION.—In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

⟦(b) PER-ISSUER LIMITATION ON TAXPAYER'S ELIGIBLE GAIN.—

⟦(1) IN GENERAL.—If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account under subsection (a) for the taxable year shall not exceed the greater of—

⟦(A) $10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subsection (a) for prior taxable years and attributable to dispositions of stock issued by such corporation, or

⟦(B) 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.

For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which such stock was originally issued.

⟦(2) ELIGIBLE GAIN.—For purposes of this subsection, the term "eligible gain" means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

⟦(3) TREATMENT OF MARRIED INDIVIDUALS.—

⟦(A) SEPARATE RETURNS.—In the case of a separate return by a married individual, paragraph (1)(A) shall be applied by substituting "$5,000,000" for "$10,000,000".

⟦(B) ALLOCATION OF EXCLUSION.—In the case of any joint return, the amount of gain taken into account under subsection (a) shall be allocated equally between the spouses for purposes of applying this subsection to subsequent taxable years.

⟦(C) MARITAL STATUS.—For purposes of this subsection, marital status shall be determined under section 7703.

⟦(c) QUALIFIED SMALL BUSINESS STOCK.—For purposes of this section—

⟦(1) IN GENERAL.—Except as otherwise provided in this section, the term "qualified small business stock" means any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if—

⟦(A) as of the date of issuance, such corporation is a qualified small business, and

⟦(B) except as provided in subsections (f) and (h), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

⟦(i) in exchange for money or other property (not including stock), or

⟦(ii) as compensation for services provided to such corporation (other than services performed as an underwriter of such stock).

⟦(2) ACTIVE BUSINESS REQUIREMENT; ETC.—

⟦(A) IN GENERAL.—Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (e) and such corporation is a C corporation.

⟦(B) SPECIAL RULE FOR CERTAIN SMALL BUSINESS INVESTMENT COMPANIES.—

⟦(i) WAIVER OF ACTIVE BUSINESS REQUIREMENT.—Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active business requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

⟦(ii) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of clause (i), the term "specialized small business investment company" means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

⟦(3) CERTAIN PURCHASES BY CORPORATION OF ITS OWN STOCK.—

⟦(A) REDEMPTIONS FROM TAXPAYER OR RELATED PERSON.—Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of such stock, the corporation issuing such stock purchased (directly or indirectly) any of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

⟦(B) SIGNIFICANT REDEMPTIONS.—Stock issued by a corporation shall not be treated as qualified business stock if, during the 2-year period beginning on the date 1 year before the issuance of such stock, such corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of such 2-year period.

⟦(C) TREATMENT OF CERTAIN TRANSACTIONS.—If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of subparagraphs (A) and (B), such corporation shall be treated as purchasing an amount of its stock equal to the amount treated as such a distribution under section 304(a).

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

⟦(1) IN GENERAL.—The term "qualified small business" means any domestic corporation which is a C corporation if—

⟦(A) the aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed $50,000,000,

⟦(B) the aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed $50,000,000, and

⟦(C) such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

⟦(2) AGGREGATE GROSS ASSETS.—

⟦(A) IN GENERAL.—For purposes of paragraph (1), the term "aggregate gross assets" means the amount of cash and the aggregate adjusted bases of other property held by the corporation.

⟦(B) TREATMENT OF CONTRIBUTED PROPERTY.—For purposes of subparagraph (A), the adjusted basis of any property contributed to the corporation (or other property with a basis determined in whole or in part by reference to the adjusted basis of property so contributed) shall be determined as if the basis of the property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution.

⟦(3) AGGREGATION RULES.—

⟦(A) IN GENERAL.—All corporations which are members of the same parent-subsidiary controlled group shall be treated as 1 corporation for purposes of this subsection.

⟦(B) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subparagraph (A), the term "parent-subsidiary controlled group" means any controlled group of corporations as defined in section 1563(a)(1), except that—

⟦(i) "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)(1), and

⟦(ii) section 1563(a)(4) shall not apply.

⟦(e) ACTIVE BUSINESS REQUIREMENT.—

⟦(1) IN GENERAL.—For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period—

⟦(A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and

⟦(B) such corporation is an eligible corporation.

⟦(2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—

⟦(A) start-up activities described in section 195(c)(1)(A),

⟦(B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

⟦(C) activities with respect to in-house research expenses described in section 41(b)(4),

assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

⟦(3) QUALIFIED TRADE OR BUSINESS.—For purposes of this subsection, the term "qualified trade or business" means any trade or business other than—

⟦(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

⟦(B) any banking, insurance, financing, leasing, investing, or similar business,

⟦(C) any farming business (including the business of raising or harvesting trees),

⟦(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

⟦(E) any business of operating a hotel, motel, restaurant, or similar business.

⟦(4) ELIGIBLE CORPORATION.—For purposes of this subsection, the term "eligible corporation" means any domestic corporation; except that such term shall not include—

⟦(A) a DISC or former DISC,

⟦(B) a corporation with respect to which an election under section 936 is in effect or which has a direct or indirect subsidiary with respect to which such an election is in effect,

⟦(C) a regulated investment company, real estate investment trust, or REMIC, and

⟦(D) a cooperative.

⟦(5) STOCK IN OTHER CORPORATIONS.—

⟦(A) LOOK-THRU IN CASE OF SUBSIDIARIES.—For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets, and to conduct its ratable share of the subsidiary's activities.

⟦(B) PORTFOLIO STOCK OR SECURITIES.—A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

⟦(C) SUBSIDIARY.—For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

⟦(6) WORKING CAPITAL.—For purposes of paragraph (1)(A), any assets which—

⟦(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

⟦(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business,

shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

⟦(7) MAXIMUM REAL ESTATE HOLDINGS.—A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

⟦(8) COMPUTER SOFTWARE ROYALTIES.—For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

⟦(f) STOCK ACQUIRED ON CONVERSION OF OTHER STOCK.—If any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is qualified small business stock in the hands of the taxpayer—

⟦(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

⟦(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

⟦(g) TREATMENT OF PASS-THRU ENTITIES.—

⟦(1) IN GENERAL.—In any amount included in gross income by reason of holding an interest in a pass-thru entity meets the requirements of paragraph (2)—

⟦(A) such amount shall be treated as gain described in subsection (a), and

⟦(B) for purposes of applying subsection (b), such amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-thru entity and the taxpayer's proportionate share of the adjusted basis of the pass-thru entity in such stock shall be taken into account.

⟦(2) REQUIREMENTS.—An amount meets the requirements of this paragraph if—

⟦(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity (determined by treating such entity as an individual) and which was held by such entity for more than 5 years, and

⟦(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such entity which was held by the taxpayer on the date on which such passthrough entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

⟦(3) LIMITATION BASED ON INTEREST ORIGINALLY HELD BY TAXPAYER.—Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the passthru entity on the date the qualified small business stock was acquired.

⟦(4) PASS-THRU ENTITY.—For purposes of this subsection, the term "pass-thru entity" means—

⟦(A) any partnership,

⟦(B) any S corporation,

⟦(C) any regulated investment company, and

⟦(D) any common trust fund.

⟦(h) CERTAIN TAX-FREE AND OTHER TRANSFERS.—For purposes of this section—

⟦(1) IN GENERAL.—In the case of a transfer described in paragraph (2), the transferee shall be treated as—

⟦(A) having acquired such stock in the same manner as the transferor, and

⟦(B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

⟦(2) DESCRIPTION OF TRANSFERS.—A transfer is described in this subsection if such transfer is—

⟦(A) by gift,

⟦(B) at death, or

⟦(C) from a partnership to a partner of stock with respect to which requirements similar to the requirements of subsection (g) are met at the time of the transfer (without regard to the 5-year holding period requirement).

⟦(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

⟦(4) INCORPORATIONS AND REORGANIZATIONS INVOLVING NON-QUALIFIED STOCK.—

⟦(A) IN GENERAL.—In the case of a transaction described in section 351 or a reorganization described in section 368, if qualified small business stock is exchanged for other stock which would not qualify as qualified small business stock but for this subparagraph, such other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

⟦(B) LIMITATION.—This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time. The preceding sentence shall not apply if the stock which is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation which (as of the time of the transfer described in subparagraph (A)) is a qualified small business.

⟦(C) SUCCESSIVE APPLICATION.—For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which such limitation applied (determined after the application of the second sentence of subparagraph (B)).

⟦(D) CONTROL TEST.—In the case of a transaction described in section 351, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was exchanged.

⟦(i) BASIS RULES.—For purposes of this section—

⟦(1) STOCK EXCHANGED FOR PROPERTY.—In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

⟦(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

⟦(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

⟦(2) TREATMENT OF CONTRIBUTIONS TO CAPITAL.—If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which such stock was originally issued, in determining the amount of the adjustment by reason of such contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

⟦(j) TREATMENT OF CERTAIN SHORT POSITIONS.—

⟦(1) IN GENERAL.—If the taxpayer has an offsetting short position with respect to any qualified small business stock, subsection (a) shall not apply to any gain from the sale or exchange of such stock unless—

⟦(A) such stock was held by the taxpayer for more than 5 years as of the first day on which there was such a short position, and

⟦(B) the taxpayer elects to recognize gain as if such stock were sold on such first day for its fair market value.

⟦(2) OFFSETTING SHORT POSITION.—For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if—

⟦(A) the taxpayer has made a short sale of substantially identical property,

⟦(B) the taxpayer has acquired an option to sell substantially identical property at a fixed price, or

⟦(C) to the extent provided in regulations, the taxpayer has entered into any other transaction which substantially reduces the risk of loss from holding such qualified small business stock.

For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

⟦(k) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through splitups, shell corporations, partnerships, or otherwise.⟧

SEC. 1202. CAPITAL GAINS DEDUCTION.

(a) GENERAL RULE.—If for any taxable year a taxpayer other than a corporation has a net capital gain, 50 percent of such gain shall be a deduction from gross income.

(b) ESTATES AND TRUSTS.—In the case of an estate or trust, the deduction shall be computed by excluding the portion (if any) of the gains for the taxable year from sales or exchanges of capital assets which, under sections 652 and 662 (relating to inclusions of amounts in gross income of beneficiaries of trusts), is includible by the income beneficiaries as gain derived from the sale or exchange of capital assets.

(c) COORDINATION WITH TREATMENT OF CAPITAL GAIN UNDER LIMITATION ON INVESTMENT INTEREST.—For purposes of this section, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii).

(d) SPECIAL RULE FOR COLLECTIBLES.—

(1) IN GENERAL.—At the election of the taxpayer, the rate of tax imposed by section 1 shall not exceed 28 percent on the excess of—

(A) the amount which would be the net capital gain for the taxable year without regard to the application of section 1222(12) to collectibles specified in such election, over

(B) the net capital gain for such year.

(2) ELECTION.—Any election under this subsection, and any specification therein, once made, shall be irrevocable.

(3) COORDINATION WITH INDEXING.—Any collectible specified in such an election shall be treated as not being an indexed asset for purposes of section 1022.

(e) TRANSITIONAL RULE.—

(1) IN GENERAL.—In the case of a taxable year which includes January 1, 1995—

(A) the amount taken into account as the net capital gain under subsection (a) shall not exceed the net capital gain determined by only taking into account gains and losses

properly taken into account for the portion of the taxable year on or after January 1, 1995, and

(B) if the net capital gain for such year exceeds the amount taken into account under subsection (a), the rate of tax imposed by section 1 on such excess shall not exceed 28 percent.

(2) SPECIAL RULES FOR PASS-THRU ENTITIES.—

(A) IN GENERAL.—In applying paragraph (1) with respect to any pass-thru entity, the determination of when gains and losses are properly taken into account shall be made at the entity level.

(B) PASS-THRU ENTITY DEFINED.—For purposes of subparagraph (A), the term "pass-thru entity" means—

(i) a regulated investment company,

(ii) a real estate investment trust,

(iii) an S corporation,

(iv) a partnership,

(v) an estate or trust, and

(vi) a common trust fund.

* * * * * * *

PART II—TREATMENT OF CAPITAL LOSSES

* * * * * * *

SEC. 1211. LIMITATION ON CAPITAL LOSSES.

(a) * * *

(b) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of—

(1) $3,000 ($1,500 in the case of a married individual filing a separate return), or

[(2) the excess of such losses over such gains.]

(2) the sum of—

(A) the excess of the net short-term capital loss over the net long-term capital gain, and

(B) one-half of the excess of the net long-term capital loss over the net short-term capital gain.

SEC. 1212. CAPITAL LOSS CARRYBACKS AND CARRYOVERS.

(a) * * *

(b) OTHER TAXPAYERS.—

(1) * * *

[(2) TREATMENT OF AMOUNTS ALLOWED UNDER SECTION 1211(b)(1) OR (2).—

[(A) IN GENERAL.—For purposes of determining the excess referred to in subparagraph (A) or (B) of paragraph (1), there shall be treated as a short-term capital gain in the taxable year an amount equal to the lesser of—

[(i) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), or

[(ii) the adjusted taxable income for such taxable year.]

(2) SPECIAL RULES.—

(A) ADJUSTMENTS.—

(i) For purposes of determining the excess referred to in paragraph (1)(A), there shall be treated as short-term capital gain in the taxable year an amount equal to the lesser of—

(I) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), or

(II) the adjusted taxable income for such taxable year.

(ii) For purposes of determining the excess referred to in paragraph (1)(B), there shall be treated as short-term capital gain in the taxable year an amount equal to the sum of—

(I) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b) or the adjusted taxable income for such taxable year, whichever is the least, plus

(II) the excess of the amount described in subclause (I) over the net short-term capital loss (determined without regard to this subsection) for such year.

(B) ADJUSTED TAXABLE INCOME.—For purposes of subparagraph (A), the term "adjusted taxable income" means taxable income increased by the sum of—

(i) the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b), and

(ii) the deduction allowed for such year under section 151 or any deduction in lieu thereof.

For purposes of the preceding sentence, any excess of the deductions allowed for the taxable year over the gross income for such year shall be taken into account as negative taxable income.

(3) TRANSITIONAL RULE.—In the case of any amount which, under paragraph (1) and section 1211(b) (as in effect for taxable years beginning before January 1, 1996), is treated as a capital loss in the first taxable year beginning after December 31, 1995, paragraph (1) and section 1211(b) (as so in effect) shall apply (and paragraph (1) and section 1211(b) as in effect for taxable years beginning after December 31, 1995, shall not apply) to the extent such amount exceeds the total of any net capital gains (determined without regard to this subsection) of taxable years beginning after December 31, 1995.

* * * * * * *

PART III—GENERAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

* * * * * * *

SEC. 1222. OTHER TERMS RELATING TO CAPITAL GAINS AND LOSSES.

For purposes of this subtitle—

(1) * * *

* * * * * * *

(12) SPECIAL RULE FOR COLLECTIBLES.—

(A) IN GENERAL.—Any gain or loss from the sale or exchange of a collectible shall be treated as a short-term capital gain or loss (as the case may be), without regard to the period such asset was held. The preceding sentence shall apply only to the extent the gain or loss is taken into account in computing taxable income.

(B) TREATMENT OF CERTAIN SALES OF INTEREST IN PARTNERSHIP, ETC.—For purposes of subparagraph (A), any gain from the sale or exchange of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles held by such entity shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751(f) shall apply for purposes of the preceding sentence.

(C) COLLECTIBLE.—For purposes of this paragraph, the term "collectible" means any capital asset which is a collectible (as defined in section 408(m) without regard to paragraph (3) thereof).

* * * * * * *

PART IV—SPECIAL RULES FOR DETERMINING CAPITAL GAINS AND LOSSES

* * * * * * *

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) personal property,

* * * * * * *

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

(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the

date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

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 subsection (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)] *section 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 [instument] *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 INVESTMENT COMPANIES

* * * * * * *

Subpart C—General Provisions

* * * * * * *

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) RESEARCH EXPENDITURES.—The adjusted basis of the total assets of a controlled foreign corporation shall be increased by the research or experimental expenditures (within the meaning of section 174) paid or incurred by such foreign corporation during the taxable year and the preceding 2 tax-

able years. Any expenditure otherwise taken into account under the preceding sentence shall be reduced by the amount of any reimbursement received by the controlled foreign corporation with respect to such expenditure.

* * * * * * *

Subchapter S—Tax Treatment of S Corporations and Other Shareholders

* * * * * * *

PART II—TAX TREATMENT OF SHAREHOLDERS

* * * * * * *

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)*.

* * * * * * *

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 C—General Provisions

* * * * * * *

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) * * *

* * * * * * *

CHAPTER 2—TAX ON SELF-EMPLOYED INCOME

* * * * * * *

SEC. 1402. DEFINITIONS.

(a) * * *

* * * * * * *

(i) SPECIAL RULES FOR OPTIONS AND COMMODITIES DEALERS.—

(1) IN GENERAL.—Notwithstanding subsection (a)(3)(A), in determining the net earnings from self-employment of any options dealer or commodities dealer, there shall not be excluded any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from section 1256 contracts or property related to such contracts, *and the deduction provided by section 1202 shall not apply.*

* * * * * * *

CHAPTER 3—WITHHOLDING OF TAX ON NONRESIDENT ALIENS AND FOREIGN CORPORATIONS

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) CERTAIN DOMESTIC PARTNERSHIPS, TRUSTS, AND ESTATES.—In the case of any disposition of a United States real property interest as defined in section 897(c) (other than a disposition described in paragraph (4) or (5)) by a domestic partnership, domestic trust, or domestic estate, such partnership, the trustee of such trust, or the executor of such estate (as the case may be) shall be required to deduct and withhold under subsection (a) a tax equal to ⟦35 percent (or, to the extent provided in regulations, 28 percent)⟧ *25 percent (or, to the extent provided in regulations, 19.8 percent)* of the gain realized to the extent such gain—

(A) is allocable to a foreign person who is a partner or beneficiary of such partnership, trust, or estate, or

(B) is allocable to a portion of the trust treated as owned by a foreign person under subpart E of part I of subchapter J.

(2) CERTAIN DISTRIBUTIONS BY FOREIGN CORPORATIONS.—In the case of any distribution by a foreign corporation on which gain is recognized under subsection (d) or (e) of section 897, the foreign corporation shall deduct and withhold under subsection (a) a tax equal to ⟦35 percent⟧ *25 percent* of the amount of gain recognized on such distribution under such subsection.

(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] *this 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. 1503. COMPUTATION AND PAYMENT OF TAX.

(a) * * *

* * * * * * *

(e) SPECIAL RULE FOR DETERMINING ADJUSTMENTS TO BASIS.—

(1) IN GENERAL.—Solely for purposes of determining gain or loss on the disposition of intragroup stock and the amount of any inclusion by reason of an excess loss account, in determining the adjustments to the basis of such intragroup stock on account of the earnings and profits of any member of an affiliated group for any consolidated year (and in determining the amount in such account)—

(A) such earnings and profits shall be determined as if section 312 were applied for such taxable year (and all preceding consolidated years of the member with respect to such group) without regard to subsections (k) and (n) thereof *and shall be determined without regard to section 168(k)*, and

* * * * * * *

SEC. 1504. DEFINITIONS.

(a) * * *

* * * * * * *

(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) * * *

* * * * * * *

(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 A—Estates of Citizens or Residents

* * * * * * *

PART I—TAX IMPOSED

* * * * * * *

SEC. 2001. IMPOSITION AND RATE OF TAX.

(a) * * *

* * * * * * *

(c) RATE SCHEDULE.—

(1) * * *

(2) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—The tentative tax determined under paragraph (1) shall be increased by an amount equal to 5 percent of so much of the amount (with respect to which the tentative tax is to be computed) as exceeds $10,000,000 but does not exceed 【$21,040,000】 *the amount at which the average tax rate under this section is 55 percent*.

* * * * * * *

PART II—CREDITS AGAINST TAX

* * * * * * *

SEC. 2010. UNIFIED CREDIT AGAINST ESTATE TAX.

(a) GENERAL RULE.—A credit of 【$192,800】 *the applicable credit amount* shall be allowed to the estate of every decedent against the tax imposed by section 2001.

* * * * * * *

(c) APPLICABLE CREDIT AMOUNT.—For purposes of this section—

(1) IN GENERAL.—The applicable credit amount is the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were the applicable exclusion amount determined in accordance with the following table:

In the case of estates of decedents dying, and gifts made, during:	*The applicable exclusion amount is:*
1996	*$700,000*
1997	*$725,000*
1998 or thereafter	*$750,000.*

(2) COST-OF-LIVING ADJUSTMENTS.—In the case of any decedent dying, and gift made, in a calendar year after 1998, the $750,000 amount set forth in paragraph (1) shall be increased by an amount equal to—

(A) $750,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar

year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

【(c)】 *(d)* LIMITATION BASED ON AMOUNT OF TAX.—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

* * * * * * *

PART III—GROSS ESTATE

* * * * * * *

SEC. 2032A. VALUATION OF CERTAIN FARM, ETC., REAL PROPERTY.

(a) VALUE BASED ON USE UNDER WHICH PROPERTY QUALIFIES.—

(1) * * *

* * * * * * *

(3) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $750,000 amount contained in paragraph (2) shall be increased by an amount equal to—

(A) $750,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

* * * * * * *

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】 *the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death* 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 12—GIFT TAX

* * * * * * *

Subchapter A—Determination of Tax Liability

* * * * * * *

SEC. 2503. TAXABLE GIFTS.

(a) * * *

⟦(b) EXCLUSIONS FROM GIFTS.—⟧

(b) EXCLUSIONS FROM GIFTS.—

(1) IN GENERAL.—In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first $10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

(2) INFLATION ADJUSTMENT.—In the case of gifts made in a calendar year after 1998, the $10,000 amount contained in paragraph (1) shall be increased by an amount equal to—

(A) $10,000, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.

* * * * * * *

SEC. 2505. UNIFIED CREDIT AGAINST GIFT TAX.

(a) GENERAL RULE.—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year an amount equal to—

(1) ❲$192,800❳ *the applicable credit amount in effect under section 2010(c) for such calendar year*, reduced by

* * * * * * *

Subchapter D—GST Exemption

* * * * * * *

SEC. 2631. GST EXEMPTION.

(a) * * *

* * * * * * *

(c) INFLATION ADJUSTMENT.—In the case of an individual who dies in any calendar year after 1998, the $1,000,000 amount contained in subsection (a) shall be increased by an amount equal to—

(1) $1,000,000, multiplied by

(2) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

* * * * * * *

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) * * *

(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

* * * * * * *

(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) * * *

(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.

* * * * * * *

(b) APPLICABLE RETAINED INTERESTS.—For purposes of this section—

(1) * * *

(2) CONTROL.—For purposes of paragraph (1)—

(A) * * *

* * * * * * *

(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) * * *

(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,

* * * * * * *

(3) QUALIFIED PAYMENT.—

(A) * * *

(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 subpara-

graph) 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):

(A) The taxable estate of the transferor in the case of a taxable event described in paragraph (3)(A)(i).

(B) The taxable gifts of the transferor for the calendar year in which the taxable event occurs in the case of a taxable event described in paragraph (3)(A)(ii) or (iii).

* * * * * * *

(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) * * *

(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

* * * * * * *

(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) ATTRIBUTION 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).*

* * * * * * *

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⟧ *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⟧ *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)❳ *section 2701(e)(3)* shall apply for purposes of determining the interests held by any individual.

* * * * * * *

Subtitle C—Employment Taxes

* * * * * * *

CHAPTER 23—FEDERAL UNEMPLOYMENT TAX ACT

* * * * * * *

SEC. 3306. DEFINITIONS.

(a) * * *

* * * * * * *

(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

Subchapter A—Withholding from 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); 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—CERTAIN OTHER EXCISE TAXES

* * * * * * *

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

* * * * * * *

CHAPTER 43—QUALIFIED PENSIONS, ETC., PLANS

* * * * * * *

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) * * *

* * * * * * *

(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)⟧ *section 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 ⟦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.

* * * * * * *

SEC. 4980A. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.

(a) * * *

* * * * * * *

(e) RETIREMENT DISTRIBUTIONS.—For purposes of this section—

(1) IN GENERAL.—The term "retirement distribution" means, with respect to any individual, the amount distributed during the taxable year under—

(A) any qualified employer plan with respect to which such individual is or was the employee, and

(B) any individual retirement plan *other than an ADS account (as defined in section 408A(b)).*

* * * * * * *

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. 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.]

(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.

* * * * * * *

(9) CONTINUATION OF LONG-TERM CARE COVERAGE NOT REQUIRED.—A group health plan shall not be treated as failing to meet the requirements of this subsection solely by reason of failing to provide coverage under any long-term care insurance contract (as defined in section 7702B(b)).

* * * * * * *

CHAPTER 51—DISTILLED SPIRITS, WINES, AND BEER

* * * * * * *

Subchapter A—Gallonage and Occupational Taxes

* * * * * * *

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) section 5001(a)(4), (5), or (6),

(2) section 5006(c) or (d), (3) section 5041(e),

❲(3) section 5041(e),❳

(3) section 5041(f),

* * * * * * *

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)] *section 6665(a)*.

* * * * * * *

SEC. 5206. CONTAINERS.

(a) * * *

* * * * * * *

(f) CROSS REFERENCES.—

(1) For other provisions relating to regulation of containers of distilled spirits, see section 5301.

(2) For provisions relating to labeling containers of distilled spirits of one gallon or less for nonindustrial uses, see [section 5(e)] *section 105(e)* of the Federal Alcohol Administration Act (27 U.S.C. 205(e)).

* * * * * * *

Subchapter F—Bonded and Taxpaid Wine Premises

* * * * * * *

PART II—OPERATIONS

* * * * * * *

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 Administrative

* * * * * * *

CHAPTER 61—INFORMATION AND RETURNS

* * * * * * *

Subchapter A—Returns and Records

* * * * * * *

Part IX. Designation for reduction of public debt.

* * * * * * *

PART II—TAX RETURNS OR STATEMENTS

* * * * * * *

Subpart B—Income Tax Returns

* * * * * * *

SEC. 6018. ESTATE TAX RETURNS.

(a) RETURNS BY EXECUTOR.—

(1) CITIZENS OR RESIDENTS.—In all cases where the gross estate at the death of a citizen or resident exceeds [$600,000] *the applicable exclusion amount in effect under section 2010(c) (as adjusted under paragraph (2) thereof) for the calendar year which includes the date of death*, the executor shall make a return with respect to the estate tax imposed by subtitle B.

* * * * * * *

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).

(ii) SPECIAL RULE FOR IN-HOUSE EXPENDITURES.—This subsection shall not apply to the in-house expenditures (within the meaning of section 162(e)(5)(B)(ii)) of an organization for a taxable year if such expenditures do not exceed $2,000. In determining whether a taxpayer exceeds the $2,000 limit under this clause, there shall not be taken into account overhead costs otherwise allocable to activities described in subparagraphs (A) and (D) of section 162(e)(1).

(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. 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. The Secretary may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence or which the Secretary determines to be appropriate to carry out the provisions of this title.❳

* * * * * * *

❲(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. 6043. LIQUIDATING⟦;⟧, ETC., TRANSACTIONS.

(a) CORPORATE LIQUIDATING, ETC., TRANSACTIONS.—Every corporation shall—

(1) Within 30 days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, make a return setting forth the terms of such resolution or plan and such other information as the Secretary shall by forms or regulations prescribe; and

* * * * * * *

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)⟧ *section 85(b)*.

* * * * * * *

SEC. 6050Q. CERTAIN LONG-TERM CARE BENEFITS.

(a) REQUIREMENT OF REPORTING.—Any person who pays long-term care benefits shall make a return, according to the forms or regulations prescribed by the Secretary, setting forth—

(1) the aggregate amount of such benefits paid by such person to any individual during any calendar year, and

(2) the name, address, and TIN of such individual.

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

(1) the name of the person making the payments, and

(2) the aggregate amount of long-term care benefits paid to the individual which are required to be shown on such return.

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

(c) LONG-TERM CARE BENEFITS.—For purposes of this section, the term "long-term care benefit" has the meaning given such term by section 91(c).

* * * * * * *

PART IX—DESIGNATION FOR REDUCTION OF PUBLIC DEBT

SEC. 6097. DESIGNATION.

(a) IN GENERAL.—Every individual with adjusted income tax liability for any taxable year may designate that a portion of such liability (not to exceed 10 percent thereof) shall be used to reduce the public debt.

(b) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year only at the time of filing the return of tax imposed by chapter 1 for the taxable year. The designation shall be made on the first page of the return or on the page bearing the taxpayer's signature.

(c) ADJUSTED INCOME TAX LIABILITY.—For purposes of this section, the term "adjusted income tax liability" means income tax liability (as defined in section 6096(b)) reduced by any amount designated under section 6096 (relating to designation of income tax payments to Presidential Election Campaign Fund).

* * * * * * *

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(g) or 59(j);] *section 1(g) or 59(j);*

* * * * * * *

Subtitle F—Procedure and Administration

* * * * * * *

CHAPTER 61—INFORMATION AND RETURNS

* * * * * * *

Subchapter B—Miscellaneous Provisions

* * * * * * *

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 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).

* * * * * * *

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.

* * * * * * *

CHAPTER 66—LIMITATIONS

Subchapter A—Limitations on Assessment and Collection

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) * * *

* * * * * * *

⟦(m) DEFICIENCY ATTRIBUTABLE TO ELECTION UNDER SECTION 43 OR 44B.—The period for assessing a deficiency attributable to any election under section 43 of 44B (or any revocation therof) shall not expire before the date 1 year after the date on which the Secretary is notified of such elction (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.—

* * * * * * *

CHAPTER 67—INTEREST

* * * * * * *

Subchapter A—Interest on Underpayments

* * * * * * *

SEC. 6601. INTEREST ON UNDERPAYMENT, NONPAYMENT, OR EXTENSIONS OF TIME FOR PAYMENT, OF TAX.

(a) * * *

* * * * * * *

(j) 4-PERCENT RATE ON CERTAIN PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166.—

(1) * * *

(2) 4-PERCENT PORTION.—For purposes of this subsection, the term "4-percent portion" means the lesser of—

(A) ❲$345,800❳ *the applicable limitation amount* reduced by the amount of the credit allowable under section 2010(a); or

(B) the amount of the tax imposed by chapter 11 which is extended as provided in section 6166.

(3) APPLICABLE LIMITATION AMOUNT.—

(A) IN GENERAL.—For purposes of paragraph (2), the applicable limitation amount is the amount of the tentative tax which would be determined under the rate schedule set forth in section 2001(c) if the amount with respect to which such tentative tax is to be computed were $1,000,000.

(B) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $1,000,000 amount contained in subparagraph (A) shall be increased by an amount equal to—

(i) $1,000,000, multiplied by

(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting "calendar year 1997" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.

【(3)】 *(4)* TREATMENT OF PAYMENTS.—If the amount of tax imposed by chapter 11 which is extended as provided in section 6166 exceeds the 4-percent portion, any payment of a portion of such amount shall, for purposes of computing interest for periods after such payment, be treated as reducing the 4-percent portion by an amount which bears the same ratio to the amount of such payment as the amount of the 4-percent portion (determined without regard to this paragraph) bears to the amount of the tax which is extended as provided in section 6166.

* * * * * * *

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】 *this 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

* * * * * * *

Subchapter B—Assessable Penalites

* * * * * * *

PART I—GENERAL PROVISIONS

* * * * * * *

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. ⟦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,

* * * * * * *

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) * * *

(B) any return required by—

(i) * * *

* * * * * * *

(ix) section 6050Q (relating to certain long-term care benefits),

⟦(ix)⟧ *(x)* section 6052(a) (relating to reporting payment of wages in the form of group-life insurance),

⟦(x)⟧ *(xi)* section 6053(c)(1) (relating to reporting with respect to certain tips),

⟦(xi)⟧ *(xii)* subsection (b) or (e) of section 1060(b) (relating to reporting requirements of transferors and transferees in certain asset acquisitions),

⟦(xii)⟧ *(xiii)* 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)⟧ *(xiv)* section 4101(d) (relating to information reporting with respect to fuels taxes)⟦.⟧, *or*

⟦(xiv)⟧ *(xv)* subparagraph (C) of section 338(h)(10) (relating to information required to be furnished to the Secretary in case of elective recognition of gain or loss).

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) * * *

* * * * * * *

(Q) section 6050Q(b) (relating to certain long-term care benefits),

[(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).

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)] *section 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.

* * * * * * *

CHAPTER 72—LICENSING AND REGISTRATION

* * * * * * *

Subchapter B—Registration

* * * * * * *

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 FORFEITURES

Subchapter A—Crimes

* * * * * * *

PART II—PENALTIES APPLICABLE TO CERTAIN TAXES

* * * * * * *

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 77—MISCELLANEOUS PROVISIONS

* * * * * * *

SEC. 7518. TAX INCENTIVES RELATING TO MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.

(a) * * *

* * * * * * *

(g) TAX TREATMENT OF NONQUALIFIED WITHDRAWALS.—

(1) * * *

* * * * * * *

(6) NONQUALIFIED WITHDRAWALS TAXED AT HIGHEST MARGINAL RATE.—

(A) IN GENERAL.—In the case of any taxable year for which there is a nonqualified withdrawal (including any amount so treated under paragraph (5)), the tax imposed by chapter 1 shall be determined—

(i) by excluding such withdrawal from gross income, and

(ii) by increasing the tax imposed by chapter 1 by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation).

With respect to the portion of any nonqualified withdrawal made out of the capital gain account ⟦during a taxable year to which section 1(h) or 1201(a) applies⟧, the rate of tax taken into account under the preceding sentence shall not exceed ⟦28 percent (34 percent⟧ *19.8 percent (25 percent* in the case of a corporation).

* * * * * * *

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 "[approporiate] *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. 7702B. TREATMENT OF LONG-TERM CARE INSURANCE.

(a) IN GENERAL.—For purposes of this title—

(1) a long-term care insurance contract shall be treated as an accident and health insurance contract,

(2) amounts (other than policyholder dividends, as defined in section 808, or premium refunds) received under a long-term care insurance contract shall be treated as amounts received for personal injuries and sickness and shall be treated as reimbursement for expenses actually incurred for medical care (as defined in section 213(d)),

(3) any plan of an employer providing coverage under a long-term care insurance contract shall be treated as an accident and health plan with respect to such coverage,

(4) except as provided in subsection (d)(3), amounts paid for a long-term care insurance contract providing the benefits described in subsection (b)(2)(A) shall be treated as payments made for insurance for purposes of section 213(d)(1)(D), and

(5) a long-term care insurance contract shall be treated as a guaranteed renewable contract subject to the rules of section 816(e).

(b) LONG-TERM CARE INSURANCE CONTRACT.—For purposes of this title—

(1) IN GENERAL.—The term "long-term care insurance contract" means any insurance contract if—

(A) the only insurance protection provided under such contract is coverage of qualified long-term care services,

(B) such contract does not pay or reimburse expenses incurred for services or items to the extent that such expenses are reimbursable under title XVIII of the Social Security Act or would be so reimbursable but for the application of a deductible or coinsurance amount,

(C) such contract is guaranteed renewable,

(D) such contract does not provide for a cash surrender value or other money that can be—

(i) paid, assigned, or pledged as collateral for a loan, or

(ii) borrowed,

other than as provided in subparagraph (E) or paragraph (2)(C), and

(E) all refunds of premiums, and all policyholder dividends or similar amounts, under such contract are to be applied as a reduction in future premiums or to increase future benefits.

(2) SPECIAL RULES.—

(A) PER DIEM, ETC. PAYMENTS PERMITTED.—A contract shall not fail to be described in subparagraph (A) or (B) of paragraph (1) by reason of payments being made on a per diem or other periodic basis without regard to the expenses incurred during the period to which the payments relate.

(B) SPECIAL RULES RELATING TO MEDICARE.—

(i) Paragraph (1)(B) shall not apply to expenses which are reimbursable under title XVIII of the Social Security Act only as a secondary payor.

(ii) No provision of law shall be construed or applied so as to prohibit the offering of a long-term care insurance contract on the basis that the contract coordinates its benefits with those provided under such title.

(C) REFUNDS OF PREMIUMS.—Paragraph (1)(E) shall not apply to any refund on the death of the insured, or on a complete surrender or cancellation of the contract, which cannot exceed the aggregate premiums paid under the contract. Any refund on a complete surrender or cancellation of the contract shall be includible in gross income to the extent that any deduction or exclusion was allowable with respect to the premiums.

(c) QUALIFIED LONG-TERM CARE SERVICES.—For purposes of this section—

(1) IN GENERAL.—The term "qualified long-term care services" means necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, and rehabilitative services, and maintenance or personal care services, which—

(A) are required by a chronically ill individual, and

(B) are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

(2) CHRONICALLY ILL INDIVIDUAL.—

(A) IN GENERAL.—The term "chronically ill individual" means any individual who has been certified by a licensed health care practitioner as—

(i) being unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days due to a loss of functional capacity or to cognitive impairment, or

(ii) having a level of disability similar (as determined by the Secretary in consultation with the Secretary of Health and Human Services) to the level of disability described in clause (i).

Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the preceding 12-month period a licensed health care practitioner has certified that such individual meets such requirements.

(B) ACTIVITIES OF DAILY LIVING.—For purposes of subparagraph (A), each of the following is an activity of daily living:

(i) Eating.

(ii) Toileting.

(iii) Transferring.

(iv) Bathing.

(v) Dressing.

(vi) Continence.

Nothing in this section shall be construed to require a contract to take into account all of the preceding activities of daily living.

(3) MAINTENANCE OR PERSONAL CARE SERVICES.—The term "maintenance or personal care services" means any care the primary purpose of which is the provision of needed assistance with any of the disabilities as a result of which the individual is a chronically ill individual (including the protection from threats to health and safety due to severe cognitive impairment).

(4) LICENSED HEALTH CARE PRACTITIONER.—The term "licensed health care practitioner" means any physician (as defined in section 1861(r)(1) of the Social Security Act) and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary.

(d) TREATMENT OF COVERAGE PROVIDED AS PART OF A LIFE INSURANCE CONTRACT.—Except as otherwise provided in regulations prescribed by the Secretary, in the case of any long-term care insurance coverage (whether or not qualified) provided by a rider on a life insurance contract—

(1) IN GENERAL.—This section shall apply as if the portion of the contract providing such coverage is a separate contract.

(2) APPLICATION OF 7702.—Section 7702(c)(2) (relating to the guideline premium limitation) shall be applied by increasing the guideline premium limitation with respect to a life insurance contract, as of any date—

(A) by the sum of any charges (but not premium payments) against the life insurance contract's cash surrender value (within the meaning of section 7702(f)(2)(A)) for such coverage made to that date under the contract, less

(B) any such charges the imposition of which reduces the premiums paid for the contract (within the meaning of section 7702(f)(1)).

(3) APPLICATION OF SECTION 213.—No deduction shall be allowed under section 213(a) for charges against the life insurance contract's cash surrender value described in paragraph (2), unless such charges are includible in income as a result of the application of section 72(e)(10) and the rider is a long-term care insurance contract under subsection (b).

(4) PORTION DEFINED.—For purposes of this subsection, the term "portion" means only the terms and benefits under a life insurance contract that are in addition to the terms and benefits under the contract without regard to the coverage under a long-term care insurance contract.

* * * * * * *

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.

* * * * * * *

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) amounts equivalent to the taxes received in the Treasury after August 31, 1982, and before January 1, 1996, under subsections (c) and (e) of section 4041 (taxes on aviation fuel) and under sections 4261 and 4271 (taxes on transportation by air);

(2) amounts determined by the Secretary of the Treasury to be equivalent to the taxes received in the Treasury after August 31, *and before* 1982, and before January 1, 1996, under section 4081 (to the extent of 14 cents per gallon), with respect to gasoline used in aircraft;

* * * * * * *

SEC. 9512. PUBLIC DEBT REDUCTION TRUST FUND.

(a) CREATION OF TRUST FUND.—There is established in the Treasury of the United States a trust fund to be known as the "Public Debt Reduction Trust Fund", consisting of any amount appropriated or credited to the Trust Fund as provided in this section or section 9602(b).

(b) TRANSFERS TO TRUST FUND.—There are hereby appropriated to the Public Debt Reduction Trust Fund amounts equivalent to the amounts designated under section 6097 (relating to designation for public debt reduction).

(c) EXPENDITURES.—Amounts in the Public Debt Reduction Trust Fund shall be used by the Secretary of the Treasury for purposes of paying at maturity, or to redeem or buy before maturity, any obligation of the Federal Government included in the public debt (other than an obligation held by the Federal Old-Age and Survivors Insurance Trust Fund, the Civil Service Retirement and Disability Fund, or the Department of Defense Military Retirement Fund). Any obligation which is paid, redeemed, or bought with amounts from the Public Debt Reduction Trust Fund shall be canceled and retired and may not be reissued.

* * * * * * *

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 AMOUNT 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⟦,⟧ would have known, that such failure existed.

* * * * * * *

SECTION 121 OF THE SOCIAL SECURITY AMENDMENTS OF 1983

SEC. 121. TAXATION OF SOCIAL SECURITY AND TIER 1 RAILROAD RETIREMENT BENEFITS.

(a) * * *

* * * * * * *

(e) TRANSFERS TO TRUST FUNDS.—

(1) IN GENERAL.—⟦(A)⟧ There are hereby appropriated to each payor fund amounts equivalent to ⟦(i)⟧ the aggregate increase in tax liabilities under chapter 1 of the Internal Revenue Code of 1986 which is attributable to the application of sections 86 and 871(a)(3) of such Code (as added by this section) to payments from such payor fund ⟦, less (ii) the amounts equivalent to the aggregate increase in tax liabilities under chapter 1 of the Internal Revenue Code of 1986 which is attributable to the amendments to section 86 of such Code made by section 13215 of the Revenue Reconciliation Act of 1993.

⟦(B) There are hereby appropriated to the hospital insurance trust fund amounts equal to the increase in tax liabilities described in subparagraph (A)(ii). Such appropriated amounts shall be transferred from the general fund of the Treasury on the basis of estimates of such tax liabilities made by the Secretary of the Treasury. Transfers shall be made pursuant to a schedule made by the Secretary of the Treasury that takes into account estimated timing of collection of such liabilities].

(2) TRANSFERS.—The amounts appropriated by paragraph (1)[(A)] to any payor fund shall be transferred from time to time (but not less frequently than quarterly) from the general fund of the Treasury on the basis of estimates made by the Secretary of the Treasury of the amounts referred to in such paragraph. Any such quarterly payment shall be made on the first day of such quarter and shall take into account social security benefits estimated to be received during such quarter. Proper adjustments shall be made in the amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred.

(3) DEFINITIONS.—For purposes of this subsection—

(A) PAYOR FUND.—The term "payor fund" means any trust fund or account from which payments of social security benefits are made.

[(B) HOSPITAL INSURANCE TRUST FUND.—The term "hospital insurance trust fund" means the fund established pursuant to section 1817 of the Social Security Act".

[(C)] SOCIAL SECURITY BENEFITS.—The term "social security benefits" has the meaning given such term by section 86(d)(1) of the Internal Revenue Code of 1954.

* * * * * * *

REVENUE RECONCILIATION ACT OF 1993

* * * * * * *

TITLE XIII—REVENUE, HEALTH CARE, HUMAN RESOURCES, INCOME SECURITY, 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".

* * * * * * *

CHAPTER 1—REVENUE PROVISIONS

* * * * * * *

Subchapter A—Training and Investment Incentives

* * * * * * *

PART II—INVESTMENT INCENTIVES

* * * * * * *

Subpart B—Capital Gain Provisions

[SEC. 13113. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

[(a) GENERAL RULE.—Part I of subchapter P of chapter 1 (relating to capital gains and losses) is amended by adding at the end thereof the following new section:

[“SEC. 1202. 50-PERCENT EXCLUSION FOR GAIN FROM CERTAIN SMALL BUSINESS STOCK.

[“(a) 50-PERCENT EXCLUSION.—In the case of a taxpayer other than a corporation, gross income shall not include 50 percent of any gain from the sale or exchange of qualified small business stock held for more than 5 years.

[“(b) PER-ISSUER LIMITATION ON TAXPAYER'S ELIGIBLE GAIN.—

[“(1) IN GENERAL.—If the taxpayer has eligible gain for the taxable year from 1 or more dispositions of stock issued by any corporation, the aggregate amount of such gain from dispositions of stock issued by such corporation which may be taken into account under subsection (a) for the taxable year shall not exceed the greater of—

[“(A) $10,000,000 reduced by the aggregate amount of eligible gain taken into account by the taxpayer under subsection (a) for prior taxable years and attributable to dispositions of stock issued by such corporation, or

[“(B) 10 times the aggregate adjusted bases of qualified small business stock issued by such corporation and disposed of by the taxpayer during the taxable year.

For purposes of subparagraph (B), the adjusted basis of any stock shall be determined without regard to any addition to basis after the date on which such stock was originally issued.

[“(2) ELIGIBLE GAIN.—For purposes of this subsection, the term ‘eligible gain’ means any gain from the sale or exchange of qualified small business stock held for more than 5 years.

[“(3) TREATMENT OF MARRIED INDIVIDUALS.—

[“(A) SEPARATE RETURNS.—In the case of a separate return by a married individual, paragraph (1)(A) shall be applied by substituting ‘$5,000,000’ for ‘$10,000,000’.

[“(B) ALLOCATION OF EXCLUSION.—In the case of any joint return, the amount of gain taken into account under subsection (a) shall be allocated equally between the spouses for purposes of applying this subsection to subsequent taxable years.

[“(C) MARITAL STATUS.—For purposes of this subsection, marital status shall be determined under section 7703.

[“(c) QUALIFIED SMALL BUSINESS STOCK.—For purposes of this section—

[“(1) IN GENERAL.—Except as otherwise provided in this section, the term ‘qualified small business stock’ means any stock in a C corporation which is originally issued after the date of the enactment of the Revenue Reconciliation Act of 1993, if—

❲"(A) as of the date of issuance, such corporation is a qualified small business, and

❲"(B) except as provided in subsections (f) and (h), such stock is acquired by the taxpayer at its original issue (directly or through an underwriter)—

❲"(i) in exchange for money or other property (not including stock), or

❲"(ii) as compensation for services provided to such corporation (other than services performed as an underwriter of such stock).

❲"(2) ACTIVE BUSINESS REQUIREMENT; ETC.—

❲"(A) IN GENERAL.—Stock in a corporation shall not be treated as qualified small business stock unless, during substantially all of the taxpayer's holding period for such stock, such corporation meets the active business requirements of subsection (e) and such corporation is a C corporation.

❲"(B) SPECIAL RULE FOR CERTAIN SMALL BUSINESS INVESTMENT COMPANIES.—

❲"(i) WAIVER OF ACTIVE BUSINESS REQUIREMENT.— Notwithstanding any provision of subsection (e), a corporation shall be treated as meeting the active business requirements of such subsection for any period during which such corporation qualifies as a specialized small business investment company.

❲"(ii) SPECIALIZED SMALL BUSINESS INVESTMENT COMPANY.—For purposes of clause (i), the term 'specialized small business investment company' means any eligible corporation (as defined in subsection (e)(4)) which is licensed to operate under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993).

❲"(3) CERTAIN PURCHASES BY CORPORATION OF ITS OWN STOCK.—

❲"(A) REDEMPTIONS FROM TAXPAYER OR RELATED PERSON.—Stock acquired by the taxpayer shall not be treated as qualified small business stock if, at any time during the 4-year period beginning on the date 2 years before the issuance of such stock, the corporation issuing such stock purchased (directly or indirectly) any of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

❲"(B) SIGNIFICANT REDEMPTIONS.—Stock issued by a corporation shall not be treated as qualified business stock if, during the 2-year period beginning on the date 1 year before the issuance of such stock, such corporation made 1 or more purchases of its stock with an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of its stock as of the beginning of such 2-year period.

❲"(C) TREATMENT OF CERTAIN TRANSACTIONS.—If any transaction is treated under section 304(a) as a distribution in redemption of the stock of any corporation, for purposes of subparagraphs (A) and (B), such corporation shall be treated as purchasing an amount of its stock equal to the amount treated as such a distribution under section 304(a).

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

[“(1) IN GENERAL.—The term ‘qualified small business’ means any domestic corporation which is a C corporation if—

[“(A) the aggregate gross assets of such corporation (or any predecessor thereof) at all times on or after the date of the enactment of the Revenue Reconciliation Act of 1993 and before the issuance did not exceed $50,000,000,

[“(B) the aggregate gross assets of such corporation immediately after the issuance (determined by taking into account amounts received in the issuance) do not exceed $50,000,000, and

[“(C) such corporation agrees to submit such reports to the Secretary and to shareholders as the Secretary may require to carry out the purposes of this section.

[“(2) AGGREGATE GROSS ASSETS.—

[“(A) IN GENERAL.—For purposes of paragraph (1), the term ‘aggregate gross assets’ means the amount of cash and the aggregate adjusted bases of other property held by the corporation.

[“(B) TREATMENT OF CONTRIBUTED PROPERTY.—For purposes of subparagraph (A), the adjusted basis of any property contributed to the corporation (or other property with a basis determined in whole or in part by reference to the adjusted basis of property so contributed) shall be determined as if the basis of the property contributed to the corporation (immediately after such contribution) were equal to its fair market value as of the time of such contribution.

[“(3) AGGREGATION RULES.—

[“(A) IN GENERAL.—All corporations which are members of the same parent-subsidiary controlled group shall be treated as 1 corporation for purposes of this subsection.

[“(B) PARENT-SUBSIDIARY CONTROLLED GROUP.—For purposes of subparagraph (A), the term ‘parent-subsidiary controlled group’ means any controlled group of corporations as defined in section 1563(a)(1), except that—

[“(i) ‘more than 50 percent’ shall be substituted for ‘at least 80 percent’ each place it appears in section 1563(a)(1), and

[“(ii) section 1563(a)(4) shall not apply.

[“(e) ACTIVE BUSINESS REQUIREMENT.—

[“(1) IN GENERAL.—For purposes of subsection (c)(2), the requirements of this subsection are met by a corporation for any period if during such period—

[“(A) at least 80 percent (by value) of the assets of such corporation are used by such corporation in the active conduct of 1 or more qualified trades or businesses, and

[“(B) such corporation is an eligible corporation.

[“(2) SPECIAL RULE FOR CERTAIN ACTIVITIES.—For purposes of paragraph (1), if, in connection with any future qualified trade or business, a corporation is engaged in—

[“(A) start-up activities described in section 195(c)(1)(A),

❲“(B) activities resulting in the payment or incurring of expenditures which may be treated as research and experimental expenditures under section 174, or

❲“(C) activities with respect to in-house research expenses described in section 41(b)(4),

assets used in such activities shall be treated as used in the active conduct of a qualified trade or business. Any determination under this paragraph shall be made without regard to whether a corporation has any gross income from such activities at the time of the determination.

❲“(3) QUALIFIED TRADE OR BUSINESS.—For purposes of this subsection, the term ‘qualified trade or business’ means any trade or business other than—

❲“(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

❲“(B) any banking, insurance, financing, leasing, investing, or similar business,

❲“(C) any farming business (including the business of raising or harvesting trees),

❲“(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

❲“(E) any business of operating a hotel, motel, restaurant, or similar business.

❲“(4) ELIGIBLE CORPORATION.—For purposes of this subsection, the term ‘eligible corporation’ means any domestic corporation; except that such term shall not include—

❲“(A) a DISC or former DISC,

❲“(B) a corporation with respect to which an election under section 936 is in effect or which has a direct or indirect subsidiary with respect to which such an election is in effect,

❲“(C) a regulated investment company, real estate investment trust, or REMIC, and

❲“(D) a cooperative.

❲“(5) STOCK IN OTHER CORPORATIONS.—

❲“(A) LOOK-THRU IN CASE OF SUBSIDIARIES.—For purposes of this subsection, stock and debt in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary’s assets, and to conduct its ratable share of the subsidiary’s activities.

❲“(B) PORTFOLIO STOCK OR SECURITIES.—A corporation shall be treated as failing to meet the requirements of paragraph (1) for any period during which more than 10 percent of the value of its assets (in excess of liabilities) consists of stock or securities in other corporations which are not subsidiaries of such corporation (other than assets described in paragraph (6)).

❲“(C) SUBSIDIARY.—For purposes of this paragraph, a corporation shall be considered a subsidiary if the parent owns more than 50 percent of the combined voting power of all classes of stock entitled to vote, or more than 50 percent in value of all outstanding stock, of such corporation.

❲“(6) WORKING CAPITAL.—For purposes of paragraph (1)(A), any assets which—

❲“(A) are held as a part of the reasonably required working capital needs of a qualified trade or business of the corporation, or

❲“(B) are held for investment and are reasonably expected to be used within 2 years to finance research and experimentation in a qualified trade or business or increases in working capital needs of a qualified trade or business,

shall be treated as used in the active conduct of a qualified trade or business. For periods after the corporation has been in existence for at least 2 years, in no event may more than 50 percent of the assets of the corporation qualify as used in the active conduct of a qualified trade or business by reason of this paragraph.

❲“(7) MAXIMUM REAL ESTATE HOLDINGS.—A corporation shall not be treated as meeting the requirements of paragraph (1) for any period during which more than 10 percent of the total value of its assets consists of real property which is not used in the active conduct of a qualified trade or business. For purposes of the preceding sentence, the ownership of, dealing in, or renting of real property shall not be treated as the active conduct of a qualified trade or business.

❲“(8) COMPUTER SOFTWARE ROYALTIES.—For purposes of paragraph (1), rights to computer software which produces active business computer software royalties (within the meaning of section 543(d)(1)) shall be treated as an asset used in the active conduct of a trade or business.

❲“(f) STOCK ACQUIRED ON CONVERSION OF OTHER STOCK.—If any stock in a corporation is acquired solely through the conversion of other stock in such corporation which is qualified small business stock in the hands of the taxpayer—

❲“(1) the stock so acquired shall be treated as qualified small business stock in the hands of the taxpayer, and

❲“(2) the stock so acquired shall be treated as having been held during the period during which the converted stock was held.

❲“(g) TREATMENT OF PASS-THRU ENTITIES.—

❲“(1) IN GENERAL.—If any amount included in gross income by reason of holding an interest in a pass-thru entity meets the requirements of paragraph (2)—

❲“(A) such amount shall be treated as gain described in subsection (a), and

❲“(B) for purposes of applying subsection (b), such amount shall be treated as gain from a disposition of stock in the corporation issuing the stock disposed of by the pass-thru entity and the taxpayer’s proportionate share of the adjusted basis of the pass-thru entity in such stock shall be taken into account.

[“(2) REQUIREMENTS.—An amount meets the requirements of this paragraph if—

[“(A) such amount is attributable to gain on the sale or exchange by the pass-thru entity of stock which is qualified small business stock in the hands of such entity (determined by treating such entity as an individual) and which was held by such entity for more than 5 years, and

[“(B) such amount is includible in the gross income of the taxpayer by reason of the holding of an interest in such entity which was held by the taxpayer on the date on which such pass-thru entity acquired such stock and at all times thereafter before the disposition of such stock by such pass-thru entity.

[“(3) LIMITATION BASED ON INTEREST ORIGINALLY HELD BY TAXPAYER.—Paragraph (1) shall not apply to any amount to the extent such amount exceeds the amount to which paragraph (1) would have applied if such amount were determined by reference to the interest the taxpayer held in the pass-thru entity on the date the qualified small business stock was acquired.

[“(4) PASS-THRU ENTITY.—For purposes of this subsection, the term ‘pass-thru entity’ means—

[“(A) any partnership,

[“(B) any S corporation,

[“(C) any regulated investment company, and

[“(D) any common trust fund.

[“(h) CERTAIN TAX-FREE AND OTHER TRANSFERS.—For purposes of this section—

[“(1) IN GENERAL.—In the case of a transfer described in paragraph (2), the transferee shall be treated as—

[“(A) having acquired such stock in the same manner as the transferor, and

[“(B) having held such stock during any continuous period immediately preceding the transfer during which it was held (or treated as held under this subsection) by the transferor.

[“(2) DESCRIPTION OF TRANSFERS.—A transfer is described in this subsection if such transfer is—

[“(A) by gift,

[“(B) at death, or

[“(C) from a partnership to a partner of stock with respect to which requirements similar to the requirements of subsection (g) are met at the time of the transfer (without regard to the 5-year holding period requirement).

[“(3) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of section 1244(d)(2) shall apply for purposes of this section.

[“(4) INCORPORATIONS AND REORGANIZATIONS INVOLVING NONQUALIFIED STOCK.—

[“(A) IN GENERAL.—In the case of a transaction described in section 351 or a reorganization described in section 368, if qualified small business stock is exchanged for other stock which would not qualify as qualified small business stock but for this subparagraph, such other stock shall be treated as qualified small business stock acquired on the date on which the exchanged stock was acquired.

[“(B) LIMITATION.—This section shall apply to gain from the sale or exchange of stock treated as qualified small business stock by reason of subparagraph (A) only to the extent of the gain which would have been recognized at the time of the transfer described in subparagraph (A) if section 351 or 368 had not applied at such time. The preceding sentence shall not apply if the stock which is treated as qualified small business stock by reason of subparagraph (A) is issued by a corporation which (as of the time of the transfer described in subparagraph (A)) is a qualified small business.

[“(C) SUCCESSIVE APPLICATION.—For purposes of this paragraph, stock treated as qualified small business stock under subparagraph (A) shall be so treated for subsequent transactions or reorganizations, except that the limitation of subparagraph (B) shall be applied as of the time of the first transfer to which such limitation applied (determined after the application of the second sentence of subparagraph (B)).

[“(D) CONTROL TEST.—In the case of a transaction described in section 351, this paragraph shall apply only if, immediately after the transaction, the corporation issuing the stock owns directly or indirectly stock representing control (within the meaning of section 368(c)) of the corporation whose stock was exchanged.

[“(i) BASIS RULES.—For purposes of this section—

[“(1) STOCK EXCHANGED FOR PROPERTY.—In the case where the taxpayer transfers property (other than money or stock) to a corporation in exchange for stock in such corporation—

[“(A) such stock shall be treated as having been acquired by the taxpayer on the date of such exchange, and

[“(B) the basis of such stock in the hands of the taxpayer shall in no event be less than the fair market value of the property exchanged.

[“(2) TREATMENT OF CONTRIBUTIONS TO CAPITAL.—If the adjusted basis of any qualified small business stock is adjusted by reason of any contribution to capital after the date on which such stock was originally issued, in determining the amount of the adjustment by reason of such contribution, the basis of the contributed property shall in no event be treated as less than its fair market value on the date of the contribution.

[“(j) TREATMENT OF CERTAIN SHORT POSITIONS.—

[“(1) IN GENERAL.—If the taxpayer has an offsetting short position with respect to any qualified small business stock, subsection (a) shall not apply to any gain from the sale or exchange of such stock unless—

[“(A) such stock was held by the taxpayer for more than 5 years as of the first day on which there was such a short position, and

[“(B) the taxpayer elects to recognize gain as if such stock were sold on such first day for its fair market value.

⟦"(2) OFFSETTING SHORT POSITION.—For purposes of paragraph (1), the taxpayer shall be treated as having an offsetting short position with respect to any qualified small business stock if—

⟦"(A) the taxpayer has made a short sale of substantially identical property,

⟦"(B) the taxpayer has acquired an option to sell substantially identical property at a fixed price, or

⟦"(C) to the extent provided in regulations, the taxpayer has entered into any other transaction which substantially reduces the risk of loss from holding such qualified small business stock.

For purposes of the preceding sentence, any reference to the taxpayer shall be treated as including a reference to any person who is related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

⟦"(k) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations to prevent the avoidance of the purposes of this section through split-ups, shell corporations, partnerships, or otherwise."

⟦(b) ONE-HALF OF EXCLUSION TREATED AS PREFERENCE FOR MINIMUM TAX.—

⟦(1) IN GENERAL.—Subsection (a) of section 57 (relating to items of tax preference) is amended by adding at the end thereof the following new paragraph:

⟦"(8) EXCLUSION FOR GAINS ON SALE OF CERTAIN SMALL BUSINESS STOCK.—An amount equal to one-half of the amount excluded from gross income for the taxable year under section 1202."

⟦(2) CONFORMING AMENDMENT.—Subclause (II) of section 53(d)(1)(B)(ii) is amended by striking "and (6)" and inserting "(6), and (8)".

⟦(c) PENALTY FOR FAILURE TO COMPLY WITH REPORTING REQUIREMENTS.—Section 6652 is amended by inserting before the last subsection thereof the following new subsection:

⟦"(k) FAILURE TO MAKE REPORTS REQUIRED UNDER SECTION 1202.—In the case of a failure to make a report required under section 1202(d)(1)(C) which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), there shall be paid (on notice and demand by the Secretary and in the same manner as tax) by the person failing to make such report, an amount equal to $50 for each report with respect to which there was such a failure. In the case of any failure due to negligence or intentional disregard, the preceding sentence shall be applied by substituting '$100' for '$50'. In the case of a report covering periods in 2 or more years, the penalty determined under preceding provisions of this subsection shall be multiplied by the number of such years."

⟦(d) CONFORMING AMENDMENTS.—

⟦(1)(A) Section 172(d)(2) (relating to modifications with respect to net operating loss deduction) is amended to read as follows:

❲"(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation—

❲"(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includable on account of gains from sales or exchanges of capital assets; and

❲"(B) the exclusion provided by section 1202 shall not be allowed."

❲(B) Subparagraph (B) of section 172(d)(4) is amended by inserting ", (2)(B)," after "paragraph (1)".

❲(2) Paragraph (4) of section 642(c) is amended to read as follows:

❲"(4) ADJUSTMENTS.—To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain described in section 1202(a), proper adjustment shall be made for any exclusion allowable to the estate or trust under section 1202. In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income)."

❲(3) Paragraph (3) of section 643(a) is amended by adding at the end thereof the following new sentence: "The exclusion under section 1202 shall not be taken into account.".

❲(4) Paragraph (4) of section 691(c) is amended by striking "1201, and 1211" and inserting "1201, 1202, and 1211".

❲(5) The second sentence of paragraph (2) of section 871(a) is amended by inserting "such gains and losses shall be determined without regard to section 1202 and" after "except that".

❲(6) The table of sections for part I of subchapter P of chapter 1 is amended by adding after the item relating to section 1201 the following new item:

❲"Sec. 1202. 50-percent exclusion for gain from certain small business stock."

❲(e) EFFECTIVE DATE.—The amendments made by this section shall apply to stock issued after the date of the enactment of this Act.❳

* * * * * * *

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)⟧ *paragraph (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) * * *

(2) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 1258. Recharacterization of gain from certain financial transactions."

(3) EFFECTIVE DATE.—The amendments made by ⟦this section⟧ *this subsection* shall apply to conversion transactions entered into after April 30, 1993.

* * * * * * *

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.

* * * * * * *

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)⟧ *section 1393(a)(2)* of such Code).

* * * * * * *

SECTION 607 OF THE MERCHANT MARINE ACT, 1936

SEC. 607. (a) * * *

* * * * * * *

(h) Tax Treatment of Nonqualified Withdrawals.

(1) * * *

* * * * * * *

(6) NONQUALIFIED WITHDRAWALS TAXED AT HIGHEST MARGINAL RATE.—

(A) IN GENERAL.—In the case of any taxable year for which there is a nonqualified withdrawal (including any amount so treated under paragraph (5)), the tax imposed by chapter 1 of the Internal Revenue Code of 1986 shall be determined—

(i) by excluding such withdrawal from gross income, and

(ii) by increasing the tax imposed by chapter 1 of such Code by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation) of such Code.

With respect to the portion of any nonqualified withdrawal made out of the capital gain account ⟦during a taxable year to which section 1(h) or 1201(a) of such Code applies】, the rate of tax taken into account under the preceding sentence shall not exceed 【28 percent (34 percent】 *19.8 percent (25 percent* in case of a corporation).

* * * * * * *

SOCIAL SECURITY ACT

* * * * * * *

TITLE II—FEDERAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE BENEFITS

* * * * * * *

REDUCTION OF INSURANCE BENEFITS

MAXIMUM BENEFITS

SEC. 203. (a) * * *

* * * * * * *

MONTHS TO WHICH EARNINGS ARE CHARGED

(f) For purposes of subsection (b)—

(1) * * *

* * * * * * *

(8)(A) * * *

* * * * * * *

【(D) Notwithstanding any other provision of this subsection, the exempt amount which is applicable to an individual who has attained retirement age (as defined in section 216(l)) before the close of the taxable year involved—

【(i) shall be \$333.33⅓ for each month of any taxable year ending after 1977 and before 1979,

【(ii) shall be \$375 for each month of any taxable year ending after 1978 and before 1980,

【(iii) shall be \$416.66⅔ for each month of any taxable year ending after 1979 and before 1981,

【(iv) shall be \$458.33⅓ for each month of any taxable year ending after 1980 and before 1982, and

【(v) shall be \$500 for each month of any taxable year ending after 1981 and before 1984.】

(D)(i) Notwithstanding any other provision of this subsection, the exempt amount which is applicable to an individual who has attained retirement age (as defined in section 216(1)) before the close of the taxable year involved shall be—

(I) for the taxable year beginning after 1995 and before 1997, \$1,250.00,

(II) for the taxable year beginning after 1996 and before 1998, \$1,583.33⅓,

(III) for the taxable year beginning after 1997 and before 1999, \$1,916.66⅔,

(IV) for the taxable year beginning after 1998 and before 2000, $2,250.00, and

(V) for the taxable year beginning after 1999 and before 2001, $2,500.00.

(ii) For purposes of subparagraph (B)(ii)(II), the increase in the exempt amount provided under clause (i)(V) shall be deemed to have resulted from a determination which shall be deemed to have been made under subparagraph (A) in 1999.

* * * * * * *

DISABILITY INSURANCE BENEFIT PAYMENTS

DISABILITY INSURANCE BENEFITS

SEC. 223.(a) * * *

* * * * * * *

DEFINITION OF DISABILITY

(d)(1) * * *

* * * * * * *

(4)(A) The Secretary shall by regulations prescribe the criteria for determining when services performed or earnings derived from services demonstrate an individual's ability to engage in substantial gainful activity. No individual who is blind shall be regarded as having demonstrated an ability to engage in substantial gainful activity on the basis of earnings that do not exceed [the exempt amount under section 203(f)(8) which is applicable to individuals described in subparagraph (D) thereof] *an amount equal to the exempt amount which would have been applicable under section 203(f)(8), to individuals described in subparagraph (D) thereof, if section 501 of the Contract With America Tax Relief Act of 1995 had not been enacted*. Notwithstanding the provisions of paragraph (2), an individual whose services or earnings meet such criteria shall, except for purposes of section 222(c), be found not to be disabled. In determining whether an individual is able to engage in substantial gainful activity by reason of his earnings, where his disability is sufficiently severe to result in a functional limitation requiring assistance in order for him to work, there shall be excluded from such earnings an amount equal to the cost (to such individual) of any attendant care services, medical devices, equipment, prostheses, and similar items and services (not including routine drugs or routine medical services unless such drugs or services are necessary for the control of the disabling condition) which are necessary (as determined by the Secretary in regulations) for that purpose, whether or not such assistance is also needed to enable him to carry out his normal daily functions; except that the amount to be excluded shall be subject to such reasonable limits as the Secretary may prescribe.

* * * * * * *

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.''

* * * * * * *

SECTION 1317 OF THE TAX REFORM ACT OF 1986

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 domed 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.*

* * * * * * *

EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

* * * * * * *

TITLE I—PROTECTION OF EMPLOYEE BENEFIT RIGHTS

* * * * * * *

PART 6—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 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 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.

* * * * * * *

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE RELATING TO RETIREMENT PLANS

* * * * * * *

PART 2—CERTAIN OTHER PROVISIONS RELATING TO QUALIFIED RETIREMENT PLANS

* * * * * * *

SEC. 1022. MISCELLANEOUS PROVISIONS.

(a) * * *

* * * * * * *

(l) QUALIFIED FOOTBALL COACHES PLAN.—For purposes of determining the qualified plan status of a qualified football coaches plan, section 3(37)(F) shall be treated as part of this title and a qualified football coaches plan shall be treated as a multiemployer collectively bargained plan for purposes of the Internal Revenue Code of 1986.

* * * * * * *

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)] *subclause (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

SEC. 7001. SHORT TITLE; ETC.

(a) SHORT TITLE.—This title may be cited as the "Revenue Reconciliation Act of 1989".

* * * * * * *

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) * * *

(ii) by striking "or section 2057(d)" in subsection (c)[(2)].

* * * * * * *

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)❳ *section 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)❳ *section 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)] *section 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 appears* 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 bargaining agreements terminate (without regard to any extension after February 28, 1986)."

* * * * * * *

VII. DISSENTING VIEWS

DISSENTING VIEWS OF THE DEMOCRATIC MEMBERS, COMMITTEE ON WAYS AND MEANS

The Republican's tax policy reflected in H.R. 1215 is fiscally irresponsible, economically unsound, distributionally inequitable, and politically dishonest. We are unable in good conscience to support it.

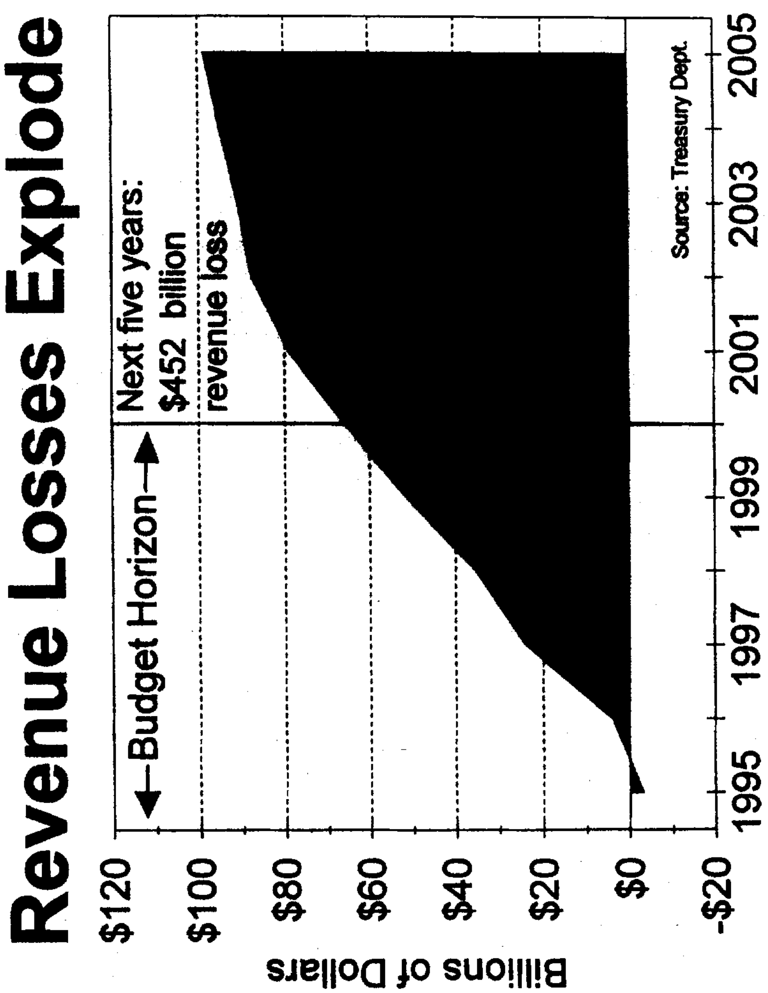
The Republican tax bill would mortgage our children's future—again—by exploding the Federal budget deficit at the very time we should be paying it down. And, the Republicans are neither paying for nor acknowledging the full size of that debt. This is the ultimate unfunded mandate.

Fiscal Irresponsibility

When you find yourself in a deep hole and it is hard to climb out, the last thing you need to do is dig the hole deeper. Despite considerable Republican rhetoric about fiscal responsibility, balancing the budget, and making government honest, the tax provisions in this bill represent the largest increase in the deficit in history except for the frenetic tax-cutting episode in 1981.

This tax bill would lose almost $200 billion over the first 5 years. And these tax cuts are insidious—they would lose vastly more in the years beyond the budget window. The 10-year revenue loss would approach $700 billion. Chart #1 illustrates this explosion of the revenue loss.

CHART #1


Revenue Losses Explode
Billions of Dollars
$120
$100
$80
$60
$40
$20
$0
-$20
1995
1997
1999
2001
2003
2005
←Budget Horizon→
Next five years:
$452 billion
revenue loss
Source: Treasury Dept.

This not only reflects a cavalier attitude toward the deficit, it is the epitome of irresponsibility. An increase in the deficit now means a larger burden on future generations. Our grandchildren can count on a lower standard of living if these tax cuts are enacted. This is the worst kind of selfishness—wanting to "have it now," even at the certain expense of our children and grandchildren. It is undisguised "me-ism."

Tax Cuts Not Paid For.—The Republicans tell us that they intend to pay for these tax cuts with spending cuts. The Republicans tell us that the cuts will not come from Social Security, defense, or interest on the public debt. We know that means other programs will have to be cut by almost one-third—even more if they intend to protect anything else. Mostly, the Republicans haven't told us much at all about the spending cuts that they say will pay for tax cuts. We haven't heard much about the specifics of where they will get the $100 billion they will need after they cut women and children from government assistance. What else do they intend to do to pay for these cuts and reduce the deficit?

This Committee has recently reported out a welfare reform bill, and other committees have considered legislation in this area, too. We suspect this is one of the ways the Republicans intend to pay for these tax cuts. We oppose paying for tax cuts by making children vulnerable. We have expressed our strong opposition to the Repbublican welfare bill. It is cruel to children and of little help to their parents. Making life harder for millions of needy children and using the savings to provide tax cuts for the privileged is offensive to us. We strenuously reiterate our opposition to this.

In fact, the Republicans don't intend to tell us how they will pay for these tax cuts because they don't know. The very day after the Committee markup, Speaker Gingrich said, "You don't have to have specific cuts. If you lower the caps, that's equivalent to specific cuts." Of course it's not! Cutting the discretionary spending caps is nothing more than a promise to spend less in the future than you're spending now. Why will it be any easier for future appropriators to find palatable specific cuts if today's appropriators cannot? And if they cannot, how tempting will it be to "adjust" the caps in order to cut less? Why should we believe that they will keep this promise, when they have broken so many in the past? Do they really intend to increase the deficit by $700 billion and expect us to take it on faith that future cuts will be forthcoming? Reporting this bill without identifying the required spending cuts is an historic act of irresponsibility.

For more than a decade, this Committee has consistently paid for any new benefits that it has approved. That risk is never easy, but we assumed that responsibility when we were elected to Congress and when we chose to serve our constituents as Members of the Committee on Ways and Means. We cannot in good conscience approve these broad tax reductions without knowing that fair and equitable spending reductions will be found to pay for this tax cut and to reduce the deficit.

Why are the Republicans making the job of balancing the budget so much harder than it already is? If they manage to come up with $200 billion in spending cuts—or, more honestly, $700 billion—they will only be running in place. They will have done nothing to reduce the current deficit. Where will they find additional cuts of as much as $1 trillion in order to balance the budget by 2002?

Budget Gimmicks.—One of the reasons for the exploding deficit increases in the years beyond the usual 5-year budget period is the budget trickery that the Republicans resort to in order to keep the early years' costs at "only" $200 billion. The bill contains a variety of gimmicks that artificially reduce its short-term revenue loss while exploding out-year costs. The following are examples of provisions contained in the bill which were deliberately designed to reduce their short-term revenue loss without regard to their long-term revenue loss:

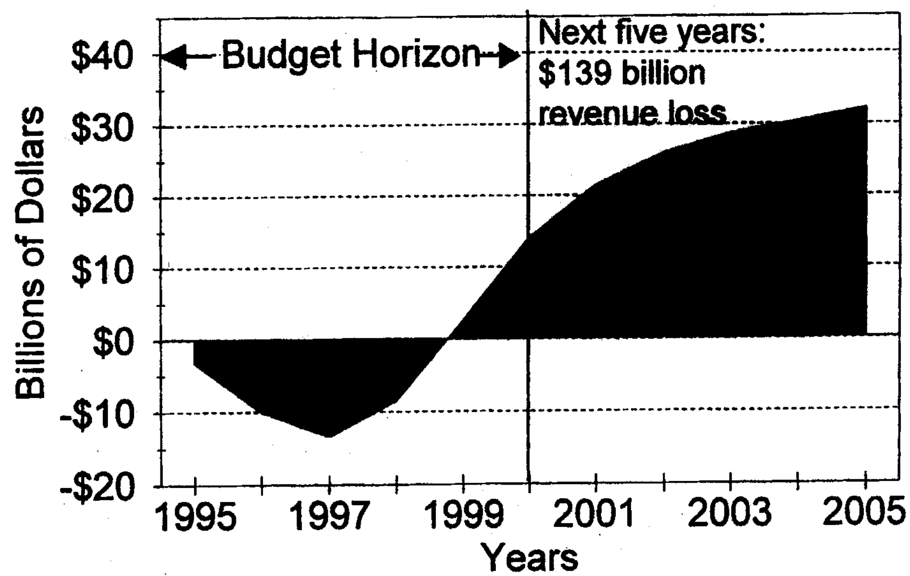
The Republican bill changes the original proposal to index capital gains for inflation that was contained in the Contract With America in several ways. One of the changes limits indexing to newly-acquired property with an election to mark-to-market property held on the effective date. This change results in a one-time revenue pickup of $11.2 billion during the first 2 years but increases its long-term costs. Another change adds a 3-year holding period, thus resulting in no revenue loss for the first 3 years. Even with additional cutbacks in the original Contract proposal, such as disqualifying corporate taxpayers, the 5th-year cost of indexing in the Committee bill exceeds the 5th-year cost of the more broadly available proposal in the original Contract by $2.2 billion.

The "neutral" cost recovery (depreciation) provisions in the bill reduce its cost by approximately $19 billion over 5 years. In fact, the Joint Committee on Taxation has estimated that these expanded deductions for business would cost almost $97 billion over the following 5 years. This provision is neither neutral nor equitable cost recovery. The provision attempts to replicate expensing which would have substantial short-term costs. Instead of simply including a provision allowing expensing, the Republican plan includes this extremely complicated depreciation scheme in order to defer the cost. (See Chart #2.)

CHART #2

Neutral Cost Recovery

Revenue losses are masked for 5 years



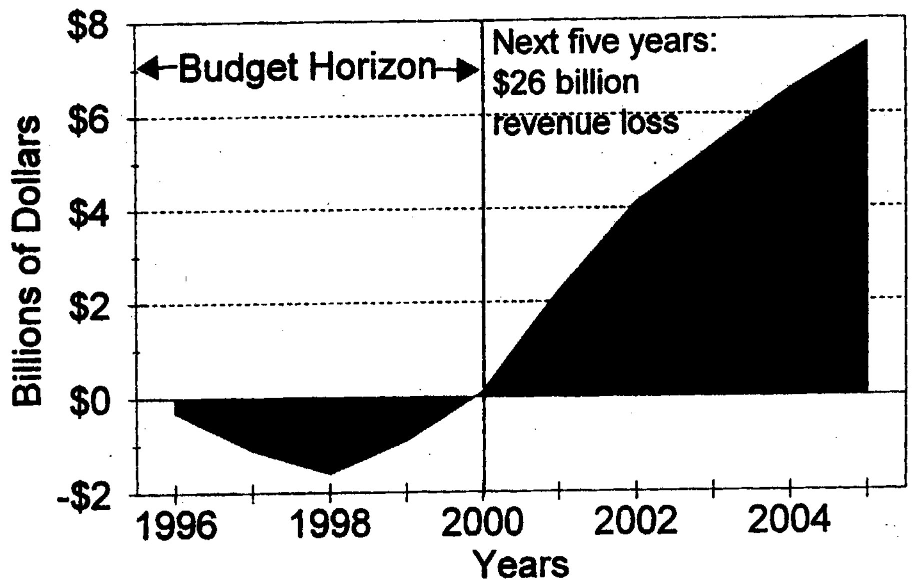
Source: Treasury Dept.

—"The American Dream Savings Account" proposal is equivalent on a present-value basis to a fully deductible IRA. However, unlike fully deductible IRAs which would cost at least $30 billion over 5 years, the American Dream Savings Account proposal purports to save $2 billion over 5 years. However, the 10-year revenue loss is approximately $24 billion and dramatically increases virtually every year thereafter. Increases in the deficit are clearly not part of any American dream. (See Chart #3.)

CHART #3

American Dream Savings Accounts

Losses are Masked and Back-Loaded



Source: Treasury Dept.

These budgetary gimmicks shift revenue into the first few years of the budget period because they assume that taxpayers will be willing to increase voluntarily the tax they owe in the short term in exchange for large tax reductions in the more distant future. Taxpayers would be willing to do this only if they are convinced that the income tax system will be in place in the more distant future. It is ironic that the Republican tax bill would rely on these gimmicks at a time when the Chairman of the Committee on Ways and Means and the House Republican Leadership are calling for total repeal of the current income tax system.

Once again the Republicans are being inconsistent. They call for deficit reduction but support large tax reductions. They say they support spending cuts but fail to identify them. They call for repeal of the present income tax system but reduce the short-term revenue loss of their tax cuts with gimmicks that will only work if taxpayers are convinced that the current system will be retained for the indefinite future. The cost of the capital gain reductions in the Republican bill is reduced by the additional revenues assumed to result from taxpayers' response to the lower rates. The lower rates will encourage taxpayers to realize additional capital gains. These induced realizations will not occur if taxpayers actually believe that the Republicans will be successful in their announced program of eliminating the income tax system. It is time for the Republicans to lay out their entire program to the American public.

Economic Unsoundness

This kind of budget irresponsibility has other, more immediate costs, too. If the financial markets doubt the government's credibility, interest rates will rise. If consumers and businesses have this windfall of additional dollars to spend at a time when the economy is charging along at full capacity, inflation will increase. If incentives are increased to shelter income, to merge companies simply because of the tax consequences, and to invest unwisely, then bad economic decisions will be made.

The memory of the 1981 Reagan tax cuts looms large. That bill gave away the store in a passion of unfunded tax-cutting, and thus encouraged the growth of tax shelters. We were promised spending cuts that never materialized. The deficit soared. The economy crashed. We experienced the deepest recession in this century short of the Great Depression. At the same time, the overly-generous tax cuts spurred over-investment in certain sectors of the economy, creating excesses that we are still trying to rid ourselves of today. If we make the same mistake this year as the one we made in 1981, then our contribution will be a weakened economy, investment distortions, and complexity.

Distributional Inequity

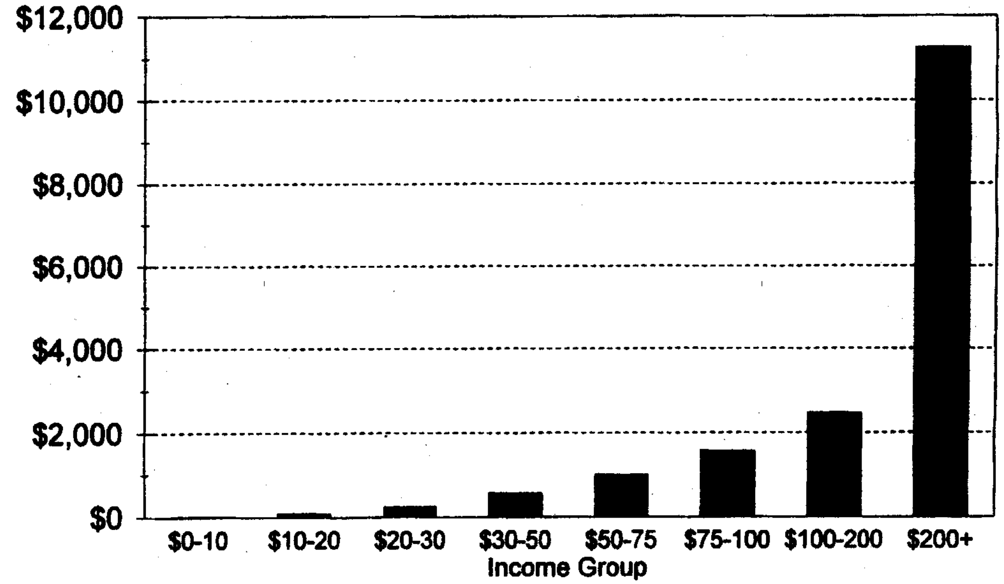
These tax proposals are not equitable. They would disproportionately favor a privileged few upper-income taxpayers. Is that a noble cause for the government to engage in—helping those who have and ignoring those who have not?

The Republicans strenuously protest the claim that they are helping wealthy Americans with these tax cuts. Indeed, at times it seems they protest too much. One-half of the total benefit of this bill and three quarters of the capital gains tax cut will go to those with incomes of $100,000 or more. The broken promise of partial refundability of the family credit means that families with incomes of $20,000 or less will get only 2 percent of the benefit of that provision, and that is about all they will get from the total bill.

On average, those with incomes of $200,000 or more would enjoy tax cuts of $11,270, while those with incomes between $30,000 and $50,000 would receive $570 and those with incomes between $50,000 and $75,000 will get about $1,000, a mere one-eleventh of what the wealthy will get. Chart #4 shows these dramatic differences.

CHART #4

"Contract" Annual Tax Benefits Per Household By Income Group



Source: Treasury Dept.

The average cut in taxes resulting from the capital gains provisions would be almost $7,800 for each family that realizes gains and has income of $200,000 or more; for a comparable family with income between $30,000 and $50,000 and lucky enough to have a capital gain, the tax cut would be about $650.

Middle-income families will get small tax cuts, a bigger deficit, and a bleaker future for their children. The Republicans know this. They put forth this bill knowingly and without the interest or the commitment to help those who are shortchanged by it.

Political Dishonesty

The Republicans campaigned on the Contract With America last year. They won the majority of seats in the House of Representatives. They say they are fervent in their determination to fulfill the Contract With America and to adhere to its associated themes. H.R. 1215 is a breach of this promise.

Breach of Contract.—H.R. 1215 denies the family tax credit to many working families with children. Virtually all of those families pay more Social Security tax than income tax, and the lower-income ones among them pay more Social Security tax than they get back in earned income tax credits. Previous versions of the Contract With America would have allowed families to use the family tax credit to offset any Social Security taxes they paid in excess of their earned income tax credit. The legislation that represented the Contract last September when it was first announced would have helped these families. H.R. 6, introduced only two months ago at the beginning of this Congress, would have helped them, too. H.R. 6 included refundability and a technical fix to ensure that refundability by making available a permanent appropriation for the refunds. It was only at the last moment, in H.R. 1215, introduced on Monday, March 13, 1995, that these families were dropped from the promise—all 10 million of them.

By not including partial refundability in H.R. 1215, the Republicans are breaking their contract with the American people and are reducing the tax relief that they promised working families by $13 billion over 5 years. Two-thirds of this reduction will come from families with incomes of less than $50,000. There are 23.2 million families with children who earn less than $50,000 per year. On average, these families pay $1,725 in Social Security tax out of their own paychecks and a total of $3,450 when the employer portion of Social Security tax is counted. Why should these families be shortchanged so that America's largest corporations can be given relief from tax?

The following examples show the effects of this contractual breach on hard-working moderate-income families.

EXAMPLES OF FAMILIES WHO WOULD GET SMALLER FAMILY TAX CREDITS UNDER THE REPUBLICAN BILL THAN UNDER THE ORIGINAL CONTRACT WITH AMERICA

Relative to the original Contract With America, H.R. 1215 makes the $500-per-child family tax credit nonrefundable. This means that many working families who would have received credits under the original Contract will receive much smaller credits under the Republican bill. The Republican bill takes $13 billion from America's working families. In fact, two-thirds of that cutback from the original Contract will come from families with less than $50,000. (Examples are for 1996.)

Example #1: Young Couple With Their First Child.—Family of 3, 1 Child, $15,000 per year.

Under the original Contract With America, this family would receive a family credit of $500.

Under the Republican bill, this family would receive a family tax credit of $90.

Relative to the original Contract, this family will lose $410.

Example #2: Middle-Aged Divorced Mother Back In the Workforce.—Family of 4, 3 Children, $20,000 per year.

Under the original Contract With America, this family would receive a family credit of $1,500.

Under the Republican bill, this family would receive a family tax credit of $585.

Relative to the original Contract, this family will lose $915.

Example #3: Family With One High-School-Educated Worker.—Family of 5, 3 Children, $22,000 per year.

Under the original Contract With America, this family would receive a family credit of $1,500.

Under the Republican bill, this family would receive a family tax credit of $375.

Relative to the original Contract, this family will lose $1,125.

Erosion of State Tax Bases.—The Republicans speak about returning government to the people and the Statehouses. The welfare reform debate in this Committee rang with the cry of "state flexibility." This tax bill will significantly circumscribe the ability of State Government to deliver services because it puts their revenue base at risk. Many States may be forced to raise real property taxes to find additional revenues. This would be especially burdensome to the middle class.

Many States use Federal tax concepts when defining taxable income for State income tax purposes. This results in substantial simplification for taxpayers who are not required to compute their income separately for Federal and State income tax purposes. A study by the Institute on Taxation and Economic Policy indicates that the depreciation and capital gain provisions contained in the Committee bill would create enormous revenue losses for States unless they cease to conform with Federal tax concepts. It is not surprising that the study indicates that 72 percent of the revenue loss is attributable to individuals with incomes over $200,000. If States cease to conform with Federal concepts, the result would be a substantial increase in complexity as taxpayers would have to compute basic concepts, such as depreciation and basis, differently for Federal and State tax purposes. The following chart shows the dramatic amounts of revenue involved.

SUMMARY OF POTENTIAL REVENUE LOSSES IN 15 STATES FROM THE CONTRACT DEPRECIATION & CAPITAL GAINS TAX CUTS

[Totals for calendar years 1995–2005, in millions of dollars]

	Corporate	Individual	Total
California	([1])	−13,420	−13,420
Connecticut	−710	−930	−1,640
Georgia	−510	−1,370	−1,880
Iowa	−210	−610	−820
Kentucky	−310	−600	−910
Maine	−60	−310	−370
Minnesota	−510	−1,900	−2,410
Missouri	−300	−910	−1,210
New Jersey	−1,090	−1,990	−3,090
New York	−2,310	−7,480	−9,790
Oregon	−160	−1,440	−1,600
Pennsylvania	−1,680	−1,350	−3,040
Rhode Island	−70	−210	−280
Vermont	−30	−130	−150
Wisconsin	−470	−150	−620
Total, 15 States	−8,430	−32,810	−41,240

[1] California does not follow federal depreciation rules for corporations.

Source: Institute on Taxation and Economic Policy.

Had it been possible to engage our Republican colleagues in realistic discussion of any issues regarding the Contract With America or the version of the Contract embodied in H.R. 1215 or to consider alternative formulations of any of the provisions in the bill, we would have preferred to address this problem and to help the States avoid these large revenue losses.

Democratic Priorities

Democrats are not opposed to tax cuts. We do believe that the unfunded Republican tax cuts in the current fiscal and economic environment are folly. We also believe that the Republican tax cuts are unfairly structured.

Sadly, the Republican bill missed a major opportunity to correct inequities and to reduce the deficit. Democrats, therefore, believe that H.R. 1215 will not restore the American dream, reinforce families, provide equity for senior citizens, or create jobs and enhance the wages of the middle class.

Had the Republicans been willing to listen to potential improvements in their bill, instead of voting in lock-step and soldier-like precision at the command of their Leadership, they would have been able to consider improvements that we, the Committee Democrats, would have been pleased to offer in a spirit of bipartisanship and to support unanimously. Some of the flaws of this legislation are described below.

Partial Refundability of the Family Tax Credit.—As mentioned above, H.R. 1215 denies the family tax credit to many working families with children even though those families typically pay more in Social Security taxes than in income taxes and, for the lower-income families, more than they receive in earned income tax credits. Previous versions of this part of the Contract With America would have helped these families by providing the family credit to families with Social Security liability in excess of their earned income tax credit. It is very difficult for the Republicans to argue, as they are now doing, that this limited refundability was not intended.

We strongly support refundability of the family credit against Social Security taxes, so that lower-income working families can benefit as well. We would have preferred to restore the partial refundability promised to working Americans in all previous versions of the Contract With America.

Meaningful Relief of Marriage Tax Penalties.—The so-called marriage penalty relief in H.R. 1215 is nothing less than an empty box. It is wholly inadequate. It would help only 14 million of the 30 million couples who experience marriage penalties each year. It purports to alleviate marriage penalties and yet it provides a maximum benefit of only $145 per couple, even though the average size of marriage penalties is large even in low- and middle-income groups: $260 for couples in the $30,000-$40,000 income range; $1,540 for couples in the $75,000-$100,000 range. It is not difficult for two working professionals, for example two school teachers, to have combined income in these ranges.

The Republican proposal is capped in order that the total revenue loss not exceed $4 billion per year. While revenue constraint is important, it makes this a false promise. At best, it will be discouraging to those who suffer marriage penalties of several hundreds or several thousands of dollars, and in a tax system in which marriage penalties may total as much as $30 or $40 billion per year. Capping the proposal at $145 per couple means that for well above 90 percent of all couples, the size of the relief will be unrelated to the size of the penalty they experience. These working Americans should not be promised relief that will not be forthcoming. Increased expectations will only be dashed and taxpayer disillusioned.

The provision in the Republican bill requires a complicated, meaningless calculation. A couple would have to compute and compare two hypothetical tax liabilities, neither of which will bear any resemblance whatsoever to their actual tax liability or any other number on their tax return. The overwhelming majority of those couples will only get $145 in relief, regardless of the calculation, because their "hypothetical" marriage penalty exceeds this capped amount. Why should we make them or the Treasury Department go through the complexity and confusion of such a calculation?

We are assured that the process of figuring out the credit will be streamlined for taxpayers because the IRS will include a "look-up" table in the tax return instruction packet. This is unlikely to be less confusing when the numbers in the table are meaningless to the taxpayer. Besides, is the look-up table really just a way of preventing taxpayers from calculating their marriage penalties themselves and realizing how big their penalty is and how paltry the Republican relief of $145 would be?

A much better approach would be to reinstate a two-earner deduction similar to the one that existed from 1982 to 1986. This method of addressing the problem of marriage penalties would help all 30 million two-earner families in a simple, straightforward way that would relate the size of the relief to the size of the penalty they face. Why not provide simple, sensible tax relief instead of an arbitrary, somewhat stingy, overly complicated credit?

Assistance With Educational Expenses.—We strongly believe that investments in both human capital and physical capital are necessary for a strong economy in this country. The Republican bill completely ignores the need to improve the skills of our workers. Without investment in the skills of our workforce, real wages of American workers will continue to decline. In 1981, the Republicans provided extraordinary subsidies for physical capital without any attempt to increase the skills of our workers. The result was an explosion of tax shelters, investments that made sense only because of the tax incentives, and a continued decline in real wages. Democrats have learned from that mistake. We prefer providing help to hard-working families who need assistance in meeting the dramatically increasing costs of education for their children.

Prevent a Raid on the Medicare Trust Fund.—We are very concerned about the impact of the bill on the Medicare Part A Hospital Insurance Trust Fund. Over the past several years, the Congress has been successful in strengthening the solvency of the Medicare Part A Hospital Insurance Trust Fund. Previous estimates of the Trustees of the Hospital Insurance Trust Fund anticipated that the Trust Fund would become insolvent in 1991. Today the Trust Fund is estimated by the Trustees to remain solvent until the year 2001.

H.R. 1215 would halt the progress made on Part A Trust Fund solvency and actually speed the day when the Trust Fund will become insolvent. The bill will take billions of dollars from the Medicare Part A Trust Fund to pay for the Contract With America. As estimated by the CBO, the Medicare Part A Trust Fund would experience a reduction of $23 billion in direct receipts over the first 5 years ($26.6 billion when accounting for lost accrued interest). By the year 2005, the Part A Trust Fund would lose $87.3 billion in direct receipts and accrued interest.

We believe that the Medicare Trust Fund, on which so many of our seniors depend, should not be raided under any circumstances. We wish it had been possible for the Committee to agree to keep the Trust Fund whole.

Add Consumer Protections to Provisions Regarding Accelerated Death Benefits.—We strongly believe in favorable tax treatment for accelerated death benefits paid to the terminally ill. After all, this was originally a Democratic proposal and introduced bill. Our strong support was demonstrated through the inclusion of such a provision in our Committee-reported health care reform legislation last year. The health care reform legislation, developed by the Committee Democrats last year and reported by the Committee, contained critical consumer protections with respect to accelerated death benefits.

We have great reservations about the Republican's proposal in this bill, however, because these consumer protections are missing. These consumer protections are necessary to ensure that the terminally ill are not exploited in their time of desperate financial need by opportunistic profiteers.

We are also greatly distressed that this favorable tax treatment has been extended to benefits paid by an unregulated industry—the viatical industry—without these consumer protections. Testimony before this Committee earlier this year established that viatical companies pay the insured a substantially lower percentage of the value of their insurance contract. These companies make a great profit at the expense of the very individuals this provision was intended to help. The extension of favorable tax treatment to the products of viatical companies makes the inclusion of these consumer protections even more critical in achieving the intended results of this provision.

Add Consumer Protections for Long-Term Care Insurance Provisions.—It is equally unfortunate that this bill does nothing to deal with the abusive practices of some insurance companies in selling long-term care insurance. Providing favorable tax treatment for long-term care insurance policies that do not provide the promised protection makes no sense whatsoever. The Republican proposal does nothing to curb the unfair practice of selling coverage without a non-forfeiture benefit or inflation protection. Coverage bought today may be worthless by the time it is needed. Consumer protection against these and other abuses should have been included as part of this proposal. In addition, the very low loss ratios of these long-term care insurance policies may mean that the tax incentives of this legislation will simply end up as higher profits in the hands of the already profitable insurance companies. As a result, as the experts told the Committee in testimony, the Republican proposal is an extremely inefficient approach to providing long-term care coverage to those in need.

Alternative Minimum Tax Reform for Corporations.—It has been our position that the present corporate alternative minimum tax should be reformed. During the hearings earlier this year, we made our position clear that the minimum tax adversely affected certain industries. This was not a new position for us as evidenced by the improvements to the alternative minimum tax contained in the 1993 Omnibus Budget Reconciliation Act. However, the Republican bill results in a total repeal of the alternative minimum tax for corporations and permits the current accumulation of alternative minimum tax credits to offset up to 90 percent of a corporation's regular tax liability. These changes, when combined with the egregious neutral cost recovery provisions contained in H.R. 1215, will result in many corporations being able to eliminate most of their Federal income tax liability. We believe this is unwise and irresponsible.

Neutral Cost Recovery System.—We strenuously oppose the neutral cost recovery provisions contained in the Republican's bill. As explained above, these provisions function largely as a budget gimmick to reduce the 5-year cost of the bill. We are particularly concerned that neutral cost recovery combined with debt-financing, would actually result in a negative tax—a negative tax that no business representative requested during the public hearings on this proposal. This would create the potential for widescale tax shelter activity. As a result, the corporate income tax would be effectively repealed for capital-intensive companies. Many companies would have excess depreciation deductions. These excess deductions would inevitably lead to tax-motivated leasing transactions and provide substantial tax incentives for mergers of capital-intensive companies with companies which have high effective tax rates. The large tax benefits associated with neutral cost recovery could create tax-motivated transactions with little or no economic justifications. The large overbuilding in real estate which occurred in the 1980s was partially caused by the unduly generous tax benefits provided in the 1981 Tax Act. We have all seen the adverse consequences resulting from that experiment in providing unduly generous depreciation rules. We should not repeat that experiment again.

Indexing of Capital Gains.—The Republican's bill makes substantial improvements to the indexing provisions that were contained in the Contract With America. These changes appropriately addressed the potential for indexing to be used to create artificial capital and ordinary losses. However, indexing will continue to be the source of substantial complexity for taxpayers. In circumstances where there have been increases to basis of property after its original acquisition, indexing would require separate adjustments for each basis increase. For example, if the taxpayer held a mutual fund and reinvested its quarterly dividends for 10 years before selling, the taxpayer would be required to compute 41 separate inflation adjustments in determining his gain or loss on the sale of his investment in that fund. Taxpayers would be required to maintain substantially more elaborate records than those required under existing law. In addition, since many States will not be able to sustain the revenue loss that would result if they allow indexing for State income tax purposes, taxpayers might be required to compute capital gains separately for Federal and State income tax purposes.

Social Security Earnings Test.—The Committee bill raises the earnings exemption under the Social Security earnings test to $30,000 by the year 2000. The bill specifically limits this provision to the elderly and excludes the blind from its benefits. In 1977 Congress, on a bipartisan basis, linked the earnings limit for the blind and the elderly. Now the Republicans are reversing that decision. They are robbing the blind of the equitable treatment they have received for almost 20 years.

Conclusion

The Republican tax bill is fatally flawed. We regret that the process in the Committee did not accommodate genuine attempts, by both Republicans and Democrats, to improve the bill and create sound tax policy. Strict adherence to the original Contract With America appears to have been the goal. Although this Republican bill breaches the original Contract in certain respects, it does not offer a better alternative.

The real Contract that America wants to have with its government is one that is fair; one that is honest; one that does not explode the deficit, jeopardize the economy, and promise to pay for it all later. Americans do not want a government in which there is a hidden agenda, internal contradictions, budget gimmickry, and enormous end-of-the-road costs.

The Republicans believe that they have a Contract With Americans. But Americans don't want these tax cuts at this cost. Americans don't want to make working families and their children suffer while corporations and wealthy individuals benefit. Americans want deficit reduction and a sound economy. They want us to climb out of the hole, not to dig it deeper.

The Contract With America has become nothing more than a hollow symbol—a contract the Republicans have with themselves to march forward with this legislation regardless of its contents or its effects.

SAM M. GIBBONS.
HAROLD FORD.
WILLIAM J. COYNE.
PETE STARK.
L.F. PAYNE.
ANDY JACOBS, Jr.
JIM MCDERMOTT.
GERALD D. KLECZKA.
RICHARD E. NEAL.
BARBARA B. KENNELLY.
SANDER LEVIN.
ROBERT T. MATSUI.
CHARLES B. RANGEL.
BENJAMIN L. CARDIN.
JOHN LEWIS.

ADDITIONAL DISSENTING VIEWS OFFERED BY REP. PETE STARK, REP. SAM GIBBONS, REP. BENJAMIN CARDIN, REP. JIM MCDERMOTT, REP. GERALD KLECZKA, REP. JOHN LEWIS, REP. CHARLES RANGEL, REP. BARBARA KENNELLY, REP. WILLIAM COYNE, AND REP. RICHARD NEAL TO H.R. 1215 ('CONTRACT ON AMERICA' TAX PROVISIONS)

Opposition to the Raid on the Medicare Part A Hospital Insurance Trust Fund

Raiding the Medicare Trust Fund is no way to fund a tax bill, particularly one that favors the wealthy over middle and lower income Americans.

H.R. 1215, if enacted, will take $26 billion out of the Medicare Part A Hospital Insurance Trust Fund over five years ($87 billion over ten years). These funds are taken out in order to finance a tax cut for the wealthiest 13 percent of seniors.

According to the Health Care Finance Administration Office of the Actuary, if the Medicare Trust is to be made whole from the provisions in H.R. 1215, the payroll tax on working Americans would need to be raised by 0.31 percent effective January 1, 1996. This would increase the HI payroll tax from the current level of 2.9 percent to 3.21 percent. The effect of doing so would be to increase the tax burden on all working Americans in order to pay for a tax cut for a small group of seniors who have an average annual income of $73,000.

In 1993, under the leadership of President Clinton, Congressional Democrats passed the Omnibus Budget Reconciliation Act of 1993. This bill *strengthened* the solvency of the Part A Trust Fund. In 1994, the Ways and Means Committee passed health reform legislation that strengthened further the solvency of the Medicare Part A Trust Fund. These improvements in the Trust Fund solvency were achieved by either reducing the draws on the Trust Fund or increasing the revenues into the Trust Fund. Neither bill had a single Republican supporter.

It is disappointing that the Republican Majority is now reversing these efforts and potentially saddling working Americans with a future tax increase, particularly when 87 percent of seniors—those with an average annual income of $18,000—receive *no* benefit from this tax cut.

While the Republicans seem to believe they have devised a contract that meets the political whims of the day, Democrats made a commitment—a contract—with Americans in 1965 when we enacted Medicare. We plan to keep that commitment.

Need for Consumer Protections in Long-Term Care Insurance

The Tax Relief Act of 1995 induces people to buy long-term care insurance (LTC) by providing favorable tax treatment for premiums on those policies. Yet the bill does nothing to protect consumers from the abuses that are present in the market. The recent past president of National Association of Insurance Commissioners has stated, "Some consumer abuses are so severe as to raise questions about the very viability of this product."

In testimony before the health subcommittee, 8 of the 14 witnesses testified as to the need for consumer protections. That testimony came from groups as diverse as the Health Insurance Association of America, the Partnership States of California, New York, and Connecticut, Consumers Union and The Coalition of LTC Financing. As Kevin Mahoney, Project Director of the California Partnership for LTC stated, "* * * [T]he standards the partnership policies must meet are key * * * Unless policies provide adequate coverage and inflation protection, purchases run a significant chance of still ending up on Medicaid." The dizzying array of policies and riders to policies and the confusing terminology make an effective choice of a policy almost impossible for the consumer.

Last year during health care reform, this Committee developed a bipartisan, consensus position that would have placed strong consumer protection standards on LTC policies. This year the new Majority on the Committee has chosen to ignore the consumer. If the Federal government is going to encourage individuals to purchase LTC insurance through tax incentives, then it has an obligation to the public to ensure that the policies purchased will meet certain minimum standards.

Need for Consumer Protections in Accelerated Death Benefits

The Tax Relief Act of 1995 provides favorable tax treatment for accelerated payments on life insurance contracts paid by insurance carriers or viatical companies. Yet the bill does little to protect terminally and chronically ill individuals from abuse. Last year during health care reform, the Committee developed a bipartisan, consensus position that would have placed consumer protections on accelerated death benefits. This year the new Majority on the Committee has chosen not to protect the interests of the terminally and chronically ill. If the Federal government is going to encourage individuals to accelerate payments on their life insurance contracts through favorable tax treatment, then it has an obligation to put the interests of the terminally and chronically ill ahead of those who profit from their misfortune.

PETE STARK.
BEN CARDEN.
GERALD KLECZKA.
CHARLES B. RANGEL.
WILLIAM J. COYNE.
SAM M. GIBBONS.
JIM MCDERMOTT.
JOHN LEWIS.
BARBARA B. KENNELLY.

RICHARD NEAL.

ADDITIONAL DISSENTING VIEWS OFFERED BY REPRESENTATIVE BARBARA B. KENNELLY TO H.R. 1215 (CONTRACT ON AMERICA TAX PROVISIONS)

Concern about potential abuse in long-term care provision

The Ways and Means Committee is one where great attention has always been paid to the details. The fine print does matter. As a Committee, we have always tried to ensure that legislation we enacted worked as intended, didn't distort marketplace consequences, and tried to prevent abuses where we knew about them.

As a long time supporter of tax incentives for long-term care, I am concerned that the bill contains a potential abuse involving single premium long-term care insurance. It appears to allow tax-free rollovers from IRAs and 401(k) plans and contains no safeguards against single premium policies. That means an individual could wait until a spouse becomes disabled, rollover his/her IRA into a single premium long-term care policy and effectively convert a taxable IRA income stream into a non-taxable long-term care income stream with no insurance risk. In addition, there is also the potential to get a medical expense deduction depending on income and medical expenses.

Last year during health care reform, this Committee developed a bipartisan, consensus position on long-term care insurance that would have included a twenty pay or life expectancy requirement. Such a requirement would go a long way toward preventing abuse of this nature. However, the new Majority on the Committee has deemed such a requirement necessary. Such abuses should be prevented before they are allowed to proliferate.

BARBARA B. KENNELLY.