105TH CONGRESS
1st Session

HOUSE OF REPRESENTATIVES

REPORT
105–220

TAXPAYER RELIEF ACT OF 1997

CONFERENCE REPORT

TO ACCOMPANY

H.R. 2014

JULY 30, 1997.—Ordered to be printed

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Mr. ARCHER, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 2014]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2014) to provide for reconciliation pursuant to subsections (b)(2) and (d) of section 105 of the concurrent resolution on the budget for fiscal year 1998, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment, insert the following:

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Taxpayer Relief Act of 1997".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) SECTION 15 NOT TO APPLY.—No amendment made by this Act shall be treated as a change in a rate of tax for purposes of section 15 of the Internal Revenue Code of 1986.

(d) WAIVER OF ESTIMATED TAX PENALTIES.—No addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1986 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to any underpayment attributable to such period to the extent such underpayment was created or increased by any provision of this Act.

(e) TABLE OF CONTENTS.—*The table of contents for this Act is as follows:*

Subtitle G—Other Simplification Provisions

Subtitle H—Other Provisions

TITLE XII—SIMPLIFICATION PROVISIONS RELATING TO INDIVIDUALS AND BUSINESSES

Subtitle A—Provisions Relating to Individuals

Subtitle B—Provisions Relating to Businesses Generally

Subtitle C—Simplification Relating to Electing Large Partnerships

PART I—GENERAL PROVISIONS

PART II—PROVISIONS RELATED TO TEFRA PARTNERSHIP PROCEEDINGS

PART III—PROVISION RELATING TO CLOSING OF PARTNERSHIP TAXABLE YEAR WITH RESPECT TO DECEASED PARTNER, ETC.

TITLE I—CHILD TAX CREDIT

SEC. 101. CHILD TAX CREDIT.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits) is amended by inserting after section 23 the following new section:

"SEC. 24. CHILD TAX CREDIT.

"(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year with respect to each qualifying child of the taxpayer an amount equal to $500 ($400 in the case of taxable years beginning in 1998).

"(b) LIMITATION BASED ON ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—The amount of the credit allowable under subsection (a) shall be reduced (but not below zero) by $50 for each $1,000 (or fraction thereof) by which the taxpayer's modified adjusted gross income exceeds the threshold amount. For purposes of the preceding sentence, the term 'modified adjusted gross income' means adjusted gross income increased by any amount excluded from gross income under section 911, 931, or 933.

"(2) THRESHOLD AMOUNT.—For purposes of paragraph (1), the term 'threshold amount' means—

"(A) $110,000 in the case of a joint return,

"(B) $75,000 in the case of an individual who is not married, and

"(C) $55,000 in the case of a married individual filing a separate return.

For purposes of this paragraph, marital status shall be determined under section 7703.

"(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 the taxable year,

"(B) such individual has not attained the age of 17 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).

"(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) ADDITIONAL CREDIT FOR FAMILIES WITH 3 OR MORE CHILDREN.—

"(1) IN GENERAL.—In the case of a taxpayer with 3 or more qualifying children for any taxable year, the amount of the credit allowed under this section shall be equal to the greater of—

"(A) the amount of the credit allowed under this section (without regard to this subsection and after application of the limitation under section 26), or

"(B) the alternative credit amount determined under paragraph (2).

"(2) ALTERNATIVE CREDIT AMOUNT.—For purposes of this subsection, the alternative credit amount is the amount of the credit which would be allowed under this section if the limitation under paragraph (3) were applied in lieu of the limitation under section 26.

"(3) LIMITATION.—The limitation under this paragraph for any taxable year is the limitation under section 26 (without regard to this subsection)—

"(A) increased by the taxpayer's social security taxes for such taxable year, and

"(B) reduced by the sum of—

"(i) the credits allowed under this part other than under subpart C or this section, and

"(ii) the credit allowed under section 32 without regard to subsection (m) thereof.

"(4) UNUSED CREDIT TO BE REFUNDABLE.—If the amount of the credit under paragraph (1)(B) exceeds the amount of the credit under paragraph (1)(A), such excess shall be treated as a credit to which subpart C applies. The rule of section 32(h) shall apply to such excess.

"(5) SOCIAL SECURITY TAXES.—For purposes of paragraph (3)—

"(A) IN GENERAL.—The term 'social security taxes' means, with respect to any taxpayer for any taxable year—

"(i) the amount of the taxes imposed by sections 3101 and 3201(a) on amounts received by the taxpayer during the calendar year in which the taxable year begins,

"(ii) 50 percent of the taxes imposed by section 1401 on the self-employment income of the taxpayer for the taxable year, and

"(iii) 50 percent of the taxes imposed by section 3211(a)(1) on amounts received by the taxpayer during the calendar year in which the taxable year begins.

"(B) COORDINATION WITH SPECIAL REFUND OF SOCIAL SECURITY TAXES.—The term 'social security taxes' shall not include any taxes to the extent the taxpayer is entitled to a special refund of such taxes under section 6413(c).

"(C) SPECIAL RULE.—Any amounts paid pursuant to an agreement under section 3121(l) (relating to agreements entered into by American employers with respect to foreign affiliates) which are equivalent to the taxes referred to in subparagraph (A)(i) shall be treated as taxes referred to in such subparagraph.

"(e) IDENTIFICATION REQUIREMENT.—No credit shall be allowed under this section to a taxpayer with respect to any qualifying child unless the taxpayer includes the name and taxpayer identification number of such qualifying child on the return of tax for the taxable year.

"(f) TAXABLE YEAR MUST BE FULL TAXABLE YEAR.—Except in the case of a taxable year closed by reason of the death of the taxpayer, no credit shall be allowable under this section in the case of a taxable year covering a period of less than 12 months.".

(b) SUPPLEMENTAL CREDIT.—Section 32 is amended by adding at the end the following new subsection:

"(m) SUPPLEMENTAL CHILD CREDIT.—

"(1) IN GENERAL.—In the case of a taxpayer with respect to whom a credit is allowed under section 24 for the taxable year, there shall be allowed as a credit under this section an amount equal to the supplemental child credit (if any) determined for such taxpayer for such taxable year under paragraph (2). Such credit shall be in addition to the credit allowed under subsection (a).

"(2) SUPPLEMENTAL CHILD CREDIT.—For purposes of this subsection, the supplemental child credit is an amount equal to the excess (if any) of—

"(A) the amount determined under section 24(d)(1)(A), over

"(B) the amount determined under section 24(d)(1)(B).

The amounts referred to in subparagraphs (A) and (B) shall be determined as if section 24(d) applied to all taxpayers.

"(3) COORDINATION WITH SECTION 24.—The amount of the credit under section 24 shall be reduced by the amount of the credit allowed under this subsection."

(c) HIGH RISK POOLS PERMITTED TO COVER SPOUSES AND DEPENDENTS OF HIGH RISK INDIVIDUALS.—Paragraph (26) of section 501(c) is amended by adding at the end the following flush sentence:

"A spouse and any qualifying child (as defined in section 24(c)) of an individual described in subparagraph (B) (without regard to this sentence) shall be treated as described in subparagraph (B).".

(d) CONFORMING AMENDMENTS.—

(1) Section 1324(b)(2) of title 31, United States Code, is amended by inserting before the period at the end ", or enacted by the Taxpayer Relief Act of 1997".

(2) Paragraph (2) of section 6213(g) (relating to the definition of mathematical or clerical errors) is amended by striking "and" at the end of subparagraph (G), by striking the period at the end of subparagraph (H) and inserting ", and", and by inserting after subparagraph (H) the following new subparagraph:

"(I) an omission of a correct TIN required under section 24(e) (relating to child tax credit) to be included on a return.".

(3) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting after the item relating to section 23 the following new item:

"Sec. 24. Child tax credit.".

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

TITLE II—EDUCATION INCENTIVES

Subtitle A—Tax Benefits Relating to Education Expenses

SEC. 201. HOPE AND LIFETIME LEARNING CREDITS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits) is amended by inserting after section 25 the following new section:

"SEC. 25A. HOPE AND LIFETIME LEARNING CREDITS.

"(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 equal to the sum of—

"(1) the Hope Scholarship Credit, plus

"(2) the Lifetime Learning Credit.

"(b) HOPE SCHOLARSHIP CREDIT.—

"(1) PER STUDENT CREDIT.—In the case of any eligible student for whom an election is in effect under this section for any taxable year, the Hope Scholarship Credit is an amount equal to the sum of—

"(A) 100 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished to the eligible student during any academic period beginning in such taxable year) as does not exceed $1,000, plus

"(B) 50 percent of such expenses so paid as exceeds $1,000 but does not exceed the applicable limit.

"(2) LIMITATIONS APPLICABLE TO HOPE SCHOLARSHIP CREDIT.—

"(A) CREDIT ALLOWED ONLY FOR 2 TAXABLE YEARS.—An election to have this section apply with respect to any eligible student for purposes of the Hope Scholarship Credit under subsection (a)(1) may not be made for any taxable year if such an election (by the taxpayer or any other individual) is in effect with respect to such student for any 2 prior taxable years.

"(B) CREDIT ALLOWED FOR YEAR ONLY IF INDIVIDUAL IS AT LEAST ½ TIME STUDENT FOR PORTION OF YEAR.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for a taxable year with respect to the qualified tuition and related expenses of an individual unless such individual is an eligible student for at least one academic period which begins during such year.

"(C) CREDIT ALLOWED ONLY FOR FIRST 2 YEARS OF POSTSECONDARY EDUCATION.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for a taxable year with respect to the qualified tuition and related expenses of an eligible student if the student has completed (before the beginning of such taxable year) the first 2 years of postsecondary education at an eligible educational institution.

"(D) DENIAL OF CREDIT IF STUDENT CONVICTED OF A FELONY DRUG OFFENSE.—The Hope Scholarship Credit under subsection (a)(1) shall not be allowed for qualified tuition and related expenses for the enrollment or attendance of a student for any academic period if such student has been convicted of a Federal or State felony offense consisting of the possession or distribution of a controlled substance before the end of the taxable year with or within which such period ends.

"(3) ELIGIBLE STUDENT.—For purposes of this subsection, the term 'eligible student' means, with respect to any academic period, a student who—

"(A) meets the requirements of section 484(a)(1) of the Higher Education Act of 1965 (20 U.S.C. 1091(a)(1)), as in effect on the date of the enactment of this section, and

"(B) is carrying at least ½ the normal full-time work load for the course of study the student is pursuing.

"(4) APPLICABLE LIMIT.—For purposes of paragraph (1)(B), the applicable limit for any taxable year is an amount equal to 2 times the dollar amount in effect under paragraph (1)(A) for such taxable year.

"(c) LIFETIME LEARNING CREDIT.—

"(1) PER TAXPAYER CREDIT.—The Lifetime Learning Credit for any taxpayer for any taxable year is an amount equal to 20 percent of so much of the qualified tuition and related expenses paid by the taxpayer during the taxable year (for education furnished during any academic period beginning in such taxable year) as does not exceed $10,000 ($5,000 in the case of taxable years beginning before January 1, 2003).

"(2) SPECIAL RULES FOR DETERMINING EXPENSES.—

"(A) COORDINATION WITH HOPE SCHOLARSHIP.—The qualified tuition and related expenses with respect to an individual who is an eligible student for whom a Hope Scholarship Credit under subsection (a)(1) is allowed for the taxable year shall not be taken into account under this subsection.

"(B) EXPENSES ELIGIBLE FOR LIFETIME LEARNING CREDIT.—For purposes of paragraph (1), qualified tuition and related expenses shall include expenses described in subsection (f)(1) with respect to any course of instruction at an eligible educational institution to acquire or improve job skills of the individual.

"(d) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—The amount which would (but for this subsection) be taken into account under subsection (a) for the taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

"(2) AMOUNT OF REDUCTION.—The amount determined under this paragraph is the amount which bears the same ratio to the amount which would be so taken into account as—

"(A) the excess of—

"(i) the taxpayer's modified adjusted gross income for such taxable year, over

"(ii) $40,000 ($80,000 in the case of a joint return), bears to

"(B) $10,000 ($20,000 in the case of a joint return).

"(3) MODIFIED ADJUSTED GROSS INCOME.—The term 'modified adjusted gross income' means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

"(e) ELECTION TO HAVE SECTION APPLY.—

"(1) IN GENERAL.—No credit shall be allowed under subsection (a) for a taxable year with respect to the qualified tuition and related expenses of an individual unless the taxpayer elects to have this section apply with respect to such individual for such year.

"(2) COORDINATION WITH EXCLUSIONS.—An election under this subsection shall not take effect with respect to an individual for any taxable year if any portion of any distribution during such taxable year from an education individual retirement account is excluded from gross income under section 530(d)(2).

"(f) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED TUITION AND RELATED EXPENSES.—

"(A) IN GENERAL.—The term 'qualified tuition and related expenses' means tuition and fees required for the enrollment or attendance of—

"(i) the taxpayer,

"(ii) the taxpayer's spouse, or

"(iii) any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151,

at an eligible educational institution for courses of instruction of such individual at such institution.

"(B) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC.—Such term does not include expenses with respect to any course or other education involving sports, games, or hobbies, unless such course or other education is part of the individual's degree program.

"(C) EXCEPTION FOR NONACADEMIC FEES.—Such term does not include student activity fees, athletic fees, insurance expenses, or other expenses unrelated to an individual's academic course of instruction.

"(2) ELIGIBLE EDUCATIONAL INSTITUTION.—The term 'eligible educational institution' means an institution—

"(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this section, and

"(B) which is eligible to participate in a program under title IV of such Act.

"(g) SPECIAL RULES.—

"(1) IDENTIFICATION REQUIREMENT.—No credit shall be allowed under subsection (a) to a taxpayer with respect to the qualified tuition and related expenses of an individual unless the taxpayer includes the name and taxpayer identification number of such individual on the return of tax for the taxable year.

"(2) ADJUSTMENT FOR CERTAIN SCHOLARSHIPS, ETC.—The amount of qualified tuition and related expenses otherwise taken into account under subsection (a) with respect to an individual for an academic period shall be reduced (before the application of subsections (b), (c), and (d)) by the sum of any amounts paid for the benefit of such individual which are allocable to such period as—

"(A) a qualified scholarship which is excludable from gross income under section 117,

"(B) an educational assistance allowance under chapter 30, 31, 32, 34, or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code, and

"(C) a payment (other than a gift, bequest, devise, or inheritance within the meaning of section 102(a)) for such individual's educational expenses, or attributable to such individual's enrollment at an eligible educational institution, which is excludable from gross income under any law of the United States.

"(3) TREATMENT OF EXPENSES PAID BY DEPENDENT.—If a deduction under section 151 with respect to an individual is allowed to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins—

"(A) no credit shall be allowed under subsection (a) to such individual for such individual's taxable year, and

"(B) qualified tuition and related expenses paid by such individual during such individual's taxable year shall be treated for purposes of this section as paid by such other taxpayer.

"(4) TREATMENT OF CERTAIN PREPAYMENTS.—If qualified tuition and related expenses are paid by the taxpayer during a taxable year for an academic period which begins during the

first 3 months following such taxable year, such academic period shall be treated for purposes of this section as beginning during such taxable year.

"(5) DENIAL OF DOUBLE BENEFIT.—No credit shall be allowed under this section for any expense for which a deduction is allowed under any other provision of this chapter.

"(6) NO CREDIT FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

"(7) NONRESIDENT ALIENS.—If the taxpayer is a nonresident alien individual for any portion of the taxable year, this section shall apply only if such individual is treated as a resident alien of the United States for purposes of this chapter by reason of an election under subsection (g) or (h) of section 6013.

"(h) INFLATION ADJUSTMENTS.—

"(1) DOLLAR LIMITATION ON AMOUNT OF CREDIT.—

"(A) IN GENERAL.—In the case of a taxable year beginning after 2001, each of the $1,000 amounts under subsection (b)(1) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) 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 2000' for 'calendar year 1992' in subparagraph (B) thereof.

"(B) ROUNDING.—If any amount as adjusted under subparagraph (A) is not a multiple of $1,000 such amount shall be rounded to the next lowest multiple of $1,000.

"(2) INCOME LIMITS.—

"(A) IN GENERAL.—In the case of a taxable year beginning after 2001, the $40,000 and $80,000 amounts in subsection (d)(2) shall each be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) 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 2000' for 'calendar year 1992' in subparagraph (B) thereof.

"(B) ROUNDING.—If any amount as adjusted under subparagraph (A) is not a multiple of $1,000, such amount shall be rounded to the next lowest multiple of $1,000.

"(i) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations providing for a recapture of the credit allowed under this section in cases where there is a refund in a subsequent taxable year of any amount which was taken into account in determining the amount of such credit.".

(b) EXTENSION OF PROCEDURES APPLICABLE TO MATHEMATICAL OR CLERICAL ERRORS.—Paragraph (2) of section 6213(g) (relating to the definition of mathematical or clerical errors), as amended by section 101, is amended by striking "and" at the end of subpara-

graph (H), by striking the period at the end of subparagraph (I) and inserting ", and", and by inserting after subparagraph (I) the following new subparagraph:

"(J) an omission of a correct TIN required under section 25A(g)(1) (relating to higher education tuition and related expenses) to be included on a return.".

(c) RETURNS RELATING TO TUITION AND RELATED EXPENSES.—

(1) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by inserting after section 6050R the following new section:

"SEC. 6050S. RETURNS RELATING TO HIGHER EDUCATION TUITION AND RELATED EXPENSES.

"(a) IN GENERAL.—Any person—

"(1) which is an eligible educational institution which receives payments for qualified tuition and related expenses with respect to any individual for any calendar year, or

"(2) which is engaged in a trade or business and which, in the course of such trade or business, makes payments during any calendar year to any individual which constitute reimbursements or refunds (or similar amounts) of qualified tuition and related expenses of such individual,

shall make the return described in subsection (b) with respect to the individual at such time as the Secretary may by regulations prescribe.

"(b) FORM AND MANNER OF RETURNS.—A return is described in this subsection if such return—

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

"(2) contains—

"(A) the name, address, and TIN of the individual with respect to whom payments described in subsection (a) were received from (or were paid to),

"(B) the name, address, and TIN of any individual certified by the individual described in subparagraph (A) as the taxpayer who will claim the individual as a dependent for purposes of the deduction allowable under section 151 for any taxable year ending with or within the calendar year, and

"(C) the—

"(i) aggregate amount of payments for qualified tuition and related expenses received with respect to the individual described in subparagraph (A) during the calendar year, and

"(ii) aggregate amount of reimbursements or refunds (or similar amounts) paid to such individual during the calendar year, and

"(D) such other information as the Secretary may prescribe.

"(c) APPLICATION TO GOVERNMENTAL UNITS.—For purposes of this section—

"(1) a governmental unit or any agency or instrumentality thereof shall be treated as a person, and

"(2) any return required under subsection (a) by such governmental entity shall be made by the officer or employee appropriately designated for the purpose of making such return.

"(d) STATEMENTS TO BE FURNISHED TO INDIVIDUALS 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 under subparagraph (A) or (B) of subsection (b)(2) a written statement showing—

"(1) the name, address, and phone number of the information contact of the person required to make such return, and

"(2) the aggregate amounts described in subparagraph (C) of subsection (b)(2).

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

"(e) DEFINITIONS.—For purposes of this section, the terms 'eligible educational institution' and 'qualified tuition and related expenses' have the meanings given such terms by section 25A.

"(f) RETURNS WHICH WOULD BE REQUIRED TO BE MADE BY 2 OR MORE PERSONS.—Except to the extent provided in regulations prescribed by the Secretary, in the case of any amount received by any person on behalf of another person, only the person first receiving such amount shall be required to make the return under subsection (a).

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section. No penalties shall be imposed under part II of subchapter B of chapter 68 with respect to any return or statement required under this section until such time as such regulations are issued.".

(2) ASSESSABLE PENALTIES.—

(A) Subparagraph (B) of section 6724(d)(1) (relating to definitions) is amended by redesignating clauses (ix) through (xiv) as clauses (x) through (xv), respectively, and by inserting after clause (viii) the following new clause:

"(ix) section 6050S (relating to returns relating to payments for qualified tuition and related expenses),".

(B) Paragraph (2) of section 6724(d) is amended by striking "or" at the end of the next to last subparagraph, by striking the period at the end of the last subparagraph and inserting ", or", and by adding at the end the following new subparagraph:

"(Z) section 6050S(d) (relating to returns relating to qualified tuition and related expenses).".

(3) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6050R the following new item:

"Sec. 6050S. Returns relating to higher education tuition and related expenses.".

(d) COORDINATION WITH SECTION 135.—Subsection (d) of section 135 is amended by redesignating paragraphs (2) and (3) as

paragraphs (3) and (4), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) COORDINATION WITH HIGHER EDUCATION CREDIT.—The amount of the qualified higher education expenses otherwise taken into account under subsection (a) with respect to the education of an individual shall be reduced (before the application of subsection (b)) by the amount of such expenses which are taken into account in determining the credit allowable to the taxpayer or any other person under section 25A with respect to such expenses.".

(e) CLERICAL AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by inserting after the item relating to section 25 the following new item:

"Sec. 25A. Higher education tuition and related expenses.".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to expenses paid after December 31, 1997 (in taxable years ending after such date), for education furnished in academic periods beginning after such date.

(2) LIFETIME LEARNING CREDIT.—Section 25A(a)(2) of the Internal Revenue Code of 1986 shall apply to expenses paid after June 30, 1998 (in taxable years ending after such date), for education furnished in academic periods beginning after such dates.

SEC. 202. DEDUCTION FOR INTEREST ON EDUCATION LOANS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 221 as section 222 and by inserting after section 220 the following new section:

"SEC. 221. INTEREST ON EDUCATION LOANS.

"(a) ALLOWANCE OF DEDUCTION.—In the case of an individual, there shall be allowed as a deduction for the taxable year an amount equal to the interest paid by the taxpayer during the taxable year on any qualified education loan.

"(b) MAXIMUM DEDUCTION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the deduction allowed by subsection (a) for the taxable year shall not exceed the amount determined in accordance with the following table:

"In the case of taxable years beginning in:	***The dollar amount is:***
1998	*$1,000*
1999	*$1,500*
2000	*$2,000*
2001 or thereafter	*$2,500.*

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

"(A) IN GENERAL.—The amount which would (but for this paragraph) be allowable as a deduction under this section shall be reduced (but not below zero) by the amount determined under subparagraph (B).

"(B) AMOUNT OF REDUCTION.—The amount determined under this subparagraph is the amount which bears the

same ratio to the amount which would be so taken into account as—

“(i) the excess of—

“(I) the taxpayer’s modified adjusted gross income for such taxable year, over

“(II) $40,000 ($60,000 in the case of a joint return), bears to

“(ii) $15,000.

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

“(i) without regard to this section and sections 135, 137, 911, 931, and 933, and

“(ii) after application of sections 86, 219, and 469.

For purposes of sections 86, 135, 137, 219, and 469, adjusted gross income shall be determined without regard to the deduction allowed under this section.

“(c) DEPENDENTS NOT ELIGIBLE FOR DEDUCTION.—No deduction shall be allowed by this section to an individual for the taxable year if a deduction under section 151 with respect to such individual is allowed to another taxpayer for the taxable year beginning in the calendar year in which such individual’s taxable year begins.

“(d) LIMIT ON PERIOD DEDUCTION ALLOWED.—A deduction shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 60 months (whether or not consecutive) in which interest payments are required. For purposes of this paragraph, any loan and all refinancings of such loan shall be treated as 1 loan.

“(e) DEFINITIONS.—For purposes of this section—

“(1) QUALIFIED EDUCATION LOAN.—The term ‘qualified education loan’ means any indebtedness incurred to pay qualified higher education expenses—

“(A) which are incurred on behalf of the taxpayer, the taxpayer’s spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred,

“(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

“(C) which are attributable to education furnished during a period during which the recipient was an eligible student.

Such term includes indebtedness used to refinance indebtedness which qualifies as a qualified education loan. The term ‘qualified education loan’ shall not include any indebtedness owed to a person who is related (within the meaning of section 267(b) or 707(b)(1)) to the taxpayer.

“(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The term ‘qualified higher education expenses’ means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the day before the date of the enactment of this Act) at an eligible educational institution, reduced by the sum of—

“(A) the amount excluded from gross income under section 127, 135, or 530 by reason of such expenses, and

“(B) the amount of any scholarship, allowance, or payment described in section 25A(g)(2).

For purposes of the preceding sentence, the term ‘eligible educational institution’ has the same meaning given such term by section 25A(f)(2), except that such term shall also include an institution conducting an internship or residency program leading to a degree or certificate awarded by an institution of higher education, a hospital, or a health care facility which offers postgraduate training.

“(3) ELIGIBLE STUDENT.—The term ‘eligible student’ has the meaning given such term by section 25A(b)(3).

“(4) DEPENDENT.—The term ‘dependent’ has the meaning given such term by section 152.

“(f) SPECIAL RULES.—

“(1) DENIAL OF DOUBLE BENEFIT.—No deduction shall be allowed under this section for any amount for which a deduction is allowable under any other provision of this chapter.

“(2) MARRIED COUPLES MUST FILE JOINT RETURN.—If the taxpayer is married at the close of the taxable year, the deduction shall be allowed under subsection (a) only if the taxpayer and the taxpayer’s spouse file a joint return for the taxable year.

“(3) MARITAL STATUS.—Marital status shall be determined in accordance with section 7703.

“(g) INFLATION ADJUSTMENTS.—

“(1) IN GENERAL.—In the case of a taxable year beginning after 2002, the $40,000 and $60,000 amounts in subsection (b)(2) 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 2001’ for ‘calendar year 1992’ in subparagraph (B) thereof.

“(2) ROUNDING.—If any amount as adjusted under paragraph (1) is not a multiple of $5,000, such amount shall be rounded to the next lowest multiple of $5,000.”.

(b) DEDUCTION ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 is amended by inserting after paragraph (16) the following new paragraph:

“(17) INTEREST ON EDUCATION LOANS.—The deduction allowed by section 221.”.

(c) REPORTING REQUIREMENT.—

(1) IN GENERAL.—Section 6050S(a)(2) (relating to returns relating to higher education tuition and related expenses) is amended to read as follows:

“(2) which is engaged in a trade or business and which, in the course of such trade or business—

“(A) makes payments during any calendar year to any individual which constitutes reimbursements or refunds (or similar amounts) of qualified tuition and related expenses of such individual, or

“(B) except as provided in regulations, receives from any individual interest aggregating $600 or more for any calendar year on 1 or more qualified education loans,”.

(2) INFORMATION.—Section 6050S(b)(2) is amended—

(A) by inserting "or interest" after "payments" in subparagraph (A), and

(B) in subparagraph (C), by striking "and" at the end of clause (i), by inserting "and" at the end of clause (ii), and by inserting after clause (ii) the following:

"(iii) aggregate amount of interest received for the calendar year from such individual,".

(3) DEFINITION.—Section 6050S(e) is amended by inserting ", and except as provided in regulations, the term 'qualified education loan' has the meaning given such term by section 221(e)(1)" after "section 25A".

(d) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1 is amended by striking the last item and inserting the following new items:

"Sec. 221. Interest on education loans.
"Sec. 222. Cross reference.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to any qualified education loan (as defined in section 221(e)(1) of the Internal Revenue Code of 1986, as added by this section) incurred on, before, or after the date of the enactment of this Act, but only with respect to—

(1) any loan interest payment due and paid after December 31, 1997, and

(2) the portion of the 60-month period referred to in section 221(d) of the Internal Revenue Code of 1986 (as added by this section) after December 31, 1997.

SEC. 203. PENALTY-FREE WITHDRAWALS FROM INDIVIDUAL RETIREMENT PLANS FOR HIGHER EDUCATION EXPENSES.

(a) IN GENERAL.—Paragraph (2) of section 72(t) (relating to exceptions to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding at the end the following new subparagraph:

"(E) DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT PLANS FOR HIGHER EDUCATION EXPENSES.—Distributions to an individual from an individual retirement plan to the extent such distributions do not exceed the qualified higher education expenses (as defined in paragraph (7)) of the taxpayer for the taxable year. Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), or (D) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).".

(b) DEFINITION.—Section 72(t) is amended by adding at the end the following new paragraph:

"(7) QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of paragraph (2)(E)—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means qualified higher education expenses (as defined in section 529(e)(3)) for education furnished to—

"(i) the taxpayer,

"(ii) the taxpayer's spouse, or

"(iii) any child (as defined in section 151(c)(3)) or grandchild of the taxpayer or the taxpayer's spouse,

at an eligible educational institution (as defined in section 529(e)(5)).

"(B) COORDINATION WITH OTHER BENEFITS.—The amount of qualified higher education expenses for any taxable year shall be reduced as provided in section 25A(g)(2).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 1997, with respect to expenses paid after such date (in taxable years ending after such date), for education furnished in academic periods beginning after such date.

Subtitle B—Expanded Education Investment Savings Opportunities

PART I—QUALIFIED TUITION PROGRAMS

SEC. 211. MODIFICATIONS OF QUALIFIED STATE TUITION PROGRAMS.

(a) QUALIFIED HIGHER EDUCATION EXPENSES TO INCLUDE ROOM AND BOARD.—Paragraph (3) of section 529(e) (defining qualified higher education expenses) is amended to read as follows:

"(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified higher education expenses' means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution.

"(B) ROOM AND BOARD INCLUDED FOR STUDENTS UNDER GUARANTEED PLANS WHO ARE AT LEAST HALF-TIME.—

"(i) IN GENERAL.—In the case of an individual who is an eligible student (as defined in section 25A(b)(3)) for any academic period, such term shall also include reasonable costs for such period (as determined under the qualified State tuition program) incurred by the designated beneficiary for room and board while attending such institution. For purposes of subsection (b)(7), a designated beneficiary shall be treated as meeting the requirements of this clause.

"(ii) LIMITATION.—The amount treated as qualified higher education expenses by reason of the preceding sentence shall not exceed the minimum amount (applicable to the student) included for room and board for such period in the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on the date of the enactment of this paragraph) for the eligible educational institution for such period."

(b) ADDITIONAL MODIFICATIONS.—

(1) MEMBER OF FAMILY.—Paragraph (2) of section 529(e) (relating to other definitions and special rules) is amended to read as follows:

"(2) MEMBER OF FAMILY.—The term 'member of the family' means—

"(A) an individual who bears a relationship to another individual which is a relationship described in paragraphs (1) through (8) of section 152(a), and

"(B) the spouse of any individual described in subparagraph (A).".

(2) ELIGIBLE EDUCATIONAL INSTITUTION.—Section 529(e) is amended by adding at the end the following:

"(5) ELIGIBLE EDUCATIONAL INSTITUTION.—The term 'eligible educational institution' means an institution—

"(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on the date of the enactment of this paragraph, and

"(B) which is eligible to participate in a program under title IV of such Act.".

(3) ESTATE AND GIFT TAX TREATMENT.—

(A) GIFT TAX TREATMENT.—

(i) Paragraph (2) of section 529(c) is amended to read as follows:

"(2) GIFT TAX TREATMENT OF CONTRIBUTIONS.—For purposes of chapters 12 and 13—

"(A) IN GENERAL.—Any contribution to a qualified tuition program on behalf of any designated beneficiary—

"(i) shall be treated as a completed gift to such beneficiary which is not a future interest in property, and

"(ii) shall not be treated as a qualified transfer under section 2503(e).

"(B) TREATMENT OF EXCESS CONTRIBUTIONS.—If the aggregate amount of contributions described in subparagraph (A) during the calendar year by a donor exceeds the limitation for such year under section 2503(b), such aggregate amount shall, at the election of the donor, be taken into account for purposes of such section ratably over the 5-year period beginning with such calendar year."

(ii) Paragraph (5) of section 529(c) is amended to read as follows:

"(5) OTHER GIFT TAX RULES.—For purposes of chapters 12 and 13—

"(A) TREATMENT OF DISTRIBUTIONS.—Except as provided in subparagraph (B), in no event shall a distribution from a qualified tuition program be treated as a taxable gift.

"(B) TREATMENT OF DESIGNATION OF NEW BENEFICIARY.—The taxes imposed by chapters 12 and 13 shall apply to a transfer by reason of a change in the designated beneficiary under the program (or a rollover to the account of a new beneficiary) only if the new beneficiary is a generation below the generation of the old beneficiary (determined in accordance with section 2651).".

(B) ESTATE TAX TREATMENT.—Paragraph (4) of section 529(c) is amended to read as follows:

"(4) ESTATE TAX TREATMENT.—

"(A) IN GENERAL.—No amount shall be includible in the gross estate of any individual for purposes of chapter 11 by reason of an interest in a qualified tuition program.

"(B) AMOUNTS INCLUDIBLE IN ESTATE OF DESIGNATED BENEFICIARY IN CERTAIN CASES.—Subparagraph (A) shall not apply to amounts distributed on account of the death of a beneficiary.

"(C) AMOUNTS INCLUDIBLE IN ESTATE OF DONOR MAKING EXCESS CONTRIBUTIONS.—In the case of a donor who makes the election described in paragraph (2)(B) and who dies before the close of the 5-year period referred to in such paragraph, notwithstanding subparagraph (A), the gross estate of the donor shall include the portion of such contributions properly allocable to periods after the date of death of the donor."

(4) PROHIBITION AGAINST INVESTMENT DIRECTION.—Section 529(b)(5) is amended by inserting "directly or indirectly" after "may not".

(c) COORDINATION WITH EDUCATION SAVINGS BOND.—Section 135(c)(2) (defining qualified higher education expenses) is amended by adding at the end the following:

"(C) CONTRIBUTIONS TO QUALIFIED STATE TUITION PROGRAM.—Such term shall include any contribution to a qualified State tuition program (as defined in section 529) on behalf of a designated beneficiary (as defined in such section) who is an individual described in subparagraph (A); but there shall be no increase in the investment in the contract for purposes of applying section 529(c)(3)(A) by reason of any portion of such contribution which is not includible in gross income by reason of this subparagraph.".

(d) CLARIFICATION OF TAXATION OF DISTRIBUTIONS.—Subparagraph (A) of section 529(c)(3) is amended by striking "section 72" and inserting "section 72(b)".

(e) TECHNICAL AMENDMENTS.—

(1)(A) The heading for part VIII of subchapter F of chapter 1 is amended to read as follows:

"PART VIII—HIGHER EDUCATION SAVINGS ENTITIES".

(B) The table of parts for subchapter F of chapter 1 is amended by striking the item relating to part VIII and inserting:

"Part VIII. Higher education savings entities.".

(2)(A) Section 529(d) is amended to read as follows:

"(d) REPORTS.—Each officer or employee having control of the qualified State tuition program or their designee shall make such reports regarding such program to the Secretary and to designated beneficiaries with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required by the Secretary.".

(B) Paragraph (2) of section 6693(a) (relating to failure to provide reports on individual retirement accounts or annuities) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) Section 529(d) (relating to qualified State tuition programs).".

*(C) The section heading for section 6693 is amended by striking "**INDIVIDUAL RETIREMENT**" and inserting "**CERTAIN TAX-FAVORED**".*

(D) The item relating to section 6693 in the table of sections for part I of subchapter B of chapter 68 is amended by striking "individual retirement" and inserting "certain tax-favored".

(f) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall take effect on January 1, 1998.

(2) EXPENSES TO INCLUDE ROOM AND BOARD.—The amendment made by subsection (a) shall take effect as if included in the amendments made by section 1806 of the Small Business Job Protection Act of 1996.

(3) ELIGIBLE EDUCATIONAL INSTITUTION.—The amendment made by subsection (b)(2) shall apply to distributions after December 31, 1997, with respect to expenses paid after such date (in taxable years ending after such date), for education furnished in academic periods beginning after such date.

(4) COORDINATION WITH EDUCATION SAVINGS BONDS.—The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 1997.

(5) ESTATE AND GIFT TAX CHANGES.—

(A) GIFT TAX CHANGES.—Paragraphs (2) and (5) of section 529(c) of the Internal Revenue Code of 1986, as amended by this section, shall apply to transfers (including designations of new beneficiaries) made after the date of the enactment of this Act.

(B) ESTATE TAX CHANGES.—Paragraph (4) of such section 529(c) shall apply to estates of decedents dying after June 8, 1997.

(6) TRANSITION RULE FOR PRE-AUGUST 20, 1996 CONTRACTS.—In the case of any contract issued prior to August 20, 1996, section 529(c)(3)(C) of the Internal Revenue Code of 1986 shall be applied for taxable years ending after August 20, 1996, without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

PART II—EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS

SEC. 213. EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) IN GENERAL.—Part VIII of subchapter F of chapter 1 (relating to qualified State tuition programs) is amended by adding at the end the following new section:

"SEC. 530. EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

"(a) GENERAL RULE.—An education individual retirement account shall be exempt from taxation under this subtitle. Notwithstanding the preceding sentence, the education individual retirement account shall be subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable organizations).

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

"(1) EDUCATION INDIVIDUAL RETIREMENT ACCOUNT.—The term 'education individual retirement account' means a trust created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the designated beneficiary of the trust (and designated as an education individual retirement account at the time created or organized), but only if the written governing instrument creating the trust meets the following requirements:

"(A) No contribution will be accepted—

"(i) unless it is in cash,

"(ii) after the date on which such beneficiary attains age 18, or

"(iii) except in the case of rollover contributions, if such contribution would result in aggregate contributions for the taxable year exceeding $500.

"(B) The trustee is a bank (as defined in section 408(n)) or another person who demonstrates to the satisfaction of the Secretary that the manner in which that person will administer the trust will be consistent with the requirements of this section or who has so demonstrated with respect to any individual retirement plan.

"(C) No part of the trust assets will be invested in life insurance contracts.

"(D) The assets of the trust shall not be commingled with other property except in a common trust fund or common investment fund.

"(E) Upon the death of the designated beneficiary, any balance to the credit of the beneficiary shall be distributed within 30 days after the date of death to the estate of such beneficiary.

"(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified higher education expenses' has the meaning given such term by section 529(e)(3), reduced as provided in section 25A(g)(2).

"(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an ac-

count, under a qualified State tuition program (as defined in section 529(b)) for the benefit of the beneficiary of the account.

“(3) ELIGIBLE EDUCATIONAL INSTITUTION.—The term ‘eligible educational institution’ has the meaning given such term by section 529(e)(5).

“(c) REDUCTION IN PERMITTED CONTRIBUTIONS BASED ON ADJUSTED GROSS INCOME.—

“(1) IN GENERAL.—The maximum amount which a contributor could otherwise make to an account under this section shall be reduced by an amount which bears the same ratio to such maximum amount as—

“(A) the excess of—

“(i) the contributor’s modified adjusted gross income for such taxable year, over

“(ii) $95,000 ($150,000 in the case of a joint return), bears to

“(B) $15,000 ($10,000 in the case of a joint return).

“(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of paragraph (1), the term ‘modified adjusted gross income’ means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

“(d) TAX TREATMENT OF DISTRIBUTIONS.—

“(1) IN GENERAL.—Any distribution shall be includible in the gross income of the distributee in the manner as provided in section 72(b).

“(2) DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.—

“(A) IN GENERAL.—No amount shall be includible in gross income under paragraph (1) if the qualified higher education expenses of the designated beneficiary during the taxable year are not less than the aggregate distributions during the taxable year.

“(B) DISTRIBUTIONS IN EXCESS OF EXPENSES.—If such aggregate distributions exceed such expenses during the taxable year, the amount otherwise includible in gross income under paragraph (1) shall be reduced by the amount which bears the same ratio to the amount which would be includible in gross income under paragraph (1) (without regard to this subparagraph) as the qualified higher education expenses bear to such aggregate distributions.

“(C) ELECTION TO WAIVE EXCLUSION.—A taxpayer may elect to waive the application of this paragraph for any taxable year.

“(3) SPECIAL RULES FOR APPLYING ESTATE AND GIFT TAXES WITH RESPECT TO ACCOUNT.—Rules similar to the rules of paragraphs (2), (4), and (5) of section 529(c) shall apply for purposes of this section.

“(4) ADDITIONAL TAX FOR DISTRIBUTIONS NOT USED FOR EDUCATIONAL EXPENSES.—

“(A) IN GENERAL.—The tax imposed by this chapter for any taxable year on any taxpayer who receives a payment or distribution from an education individual retirement ac-

count which is includible in gross income shall be increased by 10 percent of the amount which is so includible.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply if the payment or distribution is—

"(i) made to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary,

"(ii) attributable to the designated beneficiary's being disabled (within the meaning of section 72(m)(7)), or

"(iii) made on account of a scholarship, allowance, or payment described in section 25A(g)(2) received by the account holder to the extent the amount of the payment or distribution does not exceed the amount of the scholarship, allowance, or payment.

"(C) EXCESS CONTRIBUTIONS RETURNED BEFORE DUE DATE OF RETURN.—Subparagraph (A) shall not apply to the distribution of any contribution made during a taxable year on behalf of a designated beneficiary to the extent that such contribution exceeds $500 if—

"(i) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such contributor's return for such taxable year, and

"(ii) such distribution is accompanied by the amount of net income attributable to such excess contribution.

Any net income described in clause (ii) shall be included in gross income for the taxable year in which such excess contribution was made.

"(5) ROLLOVER CONTRIBUTIONS.—Paragraph (1) shall not apply to any amount paid or distributed from an education individual retirement account to the extent that the amount received is paid into another education individual retirement account for the benefit of the same beneficiary or a member of the family (within the meaning of section 529(e)(2)) of such beneficiary not later than the 60th day after the date of such payment or distribution. The preceding sentence shall not apply to any payment or distribution if it applied to any prior payment or distribution during the 12-month period ending on the date of the payment or distribution.

"(6) CHANGE IN BENEFICIARY.—Any change in the beneficiary of an education individual retirement account shall not be treated as a distribution for purposes of paragraph (1) if the new beneficiary is a member of the family (as so defined) of the old beneficiary.

"(7) SPECIAL RULES FOR DEATH AND DIVORCE.—Rules similar to the rules of paragraphs (7) and (8) of section 220(f) shall apply.

"(e) TAX TREATMENT OF ACCOUNTS.—Rules similar to the rules of paragraphs (2) and (4) of section 408(e) shall apply to any education individual retirement account.

"(f) COMMUNITY PROPERTY LAWS.—This section shall be applied without regard to any community property laws.

"(g) CUSTODIAL ACCOUNTS.—For purposes of this section, a custodial account shall be treated as a trust if the assets of such account are held by a bank (as defined in section 408(n)) or another person who demonstrates, to the satisfaction of the Secretary, that the manner in which he will administer the account will be consistent with the requirements of this section, and if the custodial account would, except for the fact that it is not a trust, constitute an account described in subsection (b)(1). For purposes of this title, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account shall be treated as the trustee thereof.

"(h) REPORTS.—The trustee of an education individual retirement account shall make such reports regarding such account to the Secretary and to the beneficiary of the account with respect to contributions, distributions, and such other matters as the Secretary may require. The reports required by this subsection shall be filed at such time and in such manner and furnished to such individuals at such time and in such manner as may be required.".

(b) TAX ON PROHIBITED TRANSACTIONS.—

(1) IN GENERAL.—Paragraph (1) of section 4975(e) (relating to prohibited transactions) is amended by striking "or" at the end of subparagraph (D), by redesignating subparagraph (E) as subparagraph (F), and by inserting after subparagraph (D) the following new subparagraph:

"(E) an education individual retirement account described in section 530, or".

(2) SPECIAL RULE.—Subsection (c) of section 4975 is amended by adding at the end of subsection (c) the following new paragraph:

"(5) SPECIAL RULE FOR EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—An individual for whose benefit an education individual retirement account is established and any contributor to such account shall be exempt from the tax imposed by this section with respect to any transaction concerning such account (which would otherwise be taxable under this section) if section 530(d) applies with respect to such transaction.".

(c) FAILURE TO PROVIDE REPORTS ON EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—Paragraph (2) of section 6693(a) (relating to failure to provide reports on individual retirement accounts or annuities) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding at the end the following new subparagraph:

"(D) Section 530(h) (relating to education individual retirement accounts).".

(d) TAX ON EXCESS CONTRIBUTIONS.—

(1) IN GENERAL.—Subsection (a) of section 4973 is amended by striking "or" at the end of paragraph (2), by adding "or" at the end of paragraph (3), and by inserting after paragraph (3) the following new paragraph:

"(4) an education individual retirement account (as defined in section 530),".

(2) EXCESS CONTRIBUTIONS DEFINED.—Section 4973 is amended by adding at the end the following new subsection:

"(e) EXCESS CONTRIBUTIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—For purposes of this section—

"(1) IN GENERAL.—In the case of education individual retirement accounts maintained for the benefit of any 1 beneficiary, the term 'excess contributions' means—

"(A) the amount by which the amount contributed for the taxable year to such accounts exceeds $500, and

"(B) any amount contributed to such accounts for any taxable year if any amount is contributed during such year to a qualified State tuition program for the benefit of such beneficiary.

"(2) SPECIAL RULES.—For purposes of paragraph (1), the following contributions shall not be taken into account:

"(A) Any contribution which is distributed out of the education individual retirement account in a distribution to which section 530(d)(4)(C) applies.

"(B) Any contribution described in section 530(b)(2)(B) to a qualified State tuition program.

"(C) Any rollover contribution.".

(e) TECHNICAL AMENDMENTS.—

(1) Section 26(b)(2) is amended by redesignating subparagraphs (E) through (P) as subparagraphs (F) through (Q), respectively, and by inserting after subparagraph (D) the following new subparagraph:

"(E) section 530(d)(3) (relating to additional tax on certain distributions from education individual retirement accounts),".

(2) Subparagraph (C) of section 135(c)(2), as added by the preceding section, is amended by inserting ", or to an education individual retirement account (as defined in section 530) on behalf of an account beneficiary," after "(as defined in such section)".

(3) The table of sections for part VIII of subchapter F of chapter 1 is amended by adding at the end the following new item:

"Sec. 530. Education individual retirement accounts.".

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

Subtitle C—Other Education Initiatives

SEC. 221. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

(a) IN GENERAL.—Subsection (d) of section 127 (relating to educational assistance programs) is amended to read as follows:

"(d) TERMINATION.—This section shall not apply to expenses paid with respect to courses beginning after May 31, 2000.".

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

SEC. 222. REPEAL OF LIMITATION ON QUALIFIED 501(c)(3) BONDS OTHER THAN HOSPITAL BONDS.

Section 145(b) (relating to qualified 501(c)(3) bond) is amended by adding at the end the following new paragraph:

"(5) TERMINATION OF LIMITATION.—This subsection shall not apply with respect to bonds issued after the date of the enactment of this paragraph as part of an issue 95 percent or more of the net proceeds of which are to be used to finance capital expenditures incurred after such date.".

SEC. 223. INCREASE IN ARBITRAGE REBATE EXCEPTION FOR GOVERNMENTAL BONDS USED TO FINANCE EDUCATION FACILITIES.

(a) IN GENERAL.—Section 148(f)(4)(D) (relating to exception for governmental units issuing $5,000,000 or less of bonds) is amended by adding at the end the following new clause:

"(vii) INCREASE IN EXCEPTION FOR BONDS FINANCING PUBLIC SCHOOL CAPITAL EXPENDITURES.—Each of the $5,000,000 amounts in the preceding provisions of this subparagraph shall be increased by the lesser of $5,000,000 or so much of the aggregate face amount of the bonds as are attributable to financing the construction (within the meaning of subparagraph (C)(iv)) of public school facilities.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after December 31, 1997.

SEC. 224. CONTRIBUTIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT FOR ELEMENTARY OR SECONDARY SCHOOL PURPOSES.

(a) CONTRIBUTIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT FOR ELEMENTARY OR SECONDARY SCHOOL PURPOSES.—Subsection (e) of section 170 is amended by adding at the end the following new paragraph:

"(6) SPECIAL RULE FOR CONTRIBUTIONS OF COMPUTER TECHNOLOGY AND EQUIPMENT FOR ELEMENTARY OR SECONDARY SCHOOL PURPOSES.—

"(A) LIMIT ON REDUCTION.—In the case of a qualified elementary or secondary educational contribution, the reduction under paragraph (1)(A) shall be no greater than the amount determined under paragraph (3)(B).

"(B) QUALIFIED ELEMENTARY OR SECONDARY EDUCATIONAL CONTRIBUTION.—For purposes of this paragraph, the term 'qualified elementary or secondary educational contribution' means a charitable contribution by a corporation of any computer technology or equipment, but only if—

"(i) the contribution is to—

"(I) an educational organization described in subsection (b)(1)(A)(ii), or

"(II) an entity described in section 501(c)(3) and exempt from tax under section 501(a) (other than an entity described in subclause (I)) that is organized primarily for purposes of supporting elementary and secondary education,

"(ii) the contribution is made not later than 2 years after the date the taxpayer acquired the property (or in the case of property constructed by the taxpayer, the date the construction of the property is substantially completed),

"(iii) the original use of the property is by the donor or the donee,

"(iv) substantially all of the use of the property by the donee is for use within the United States for educational purposes in any of the grades K–12 that are related to the purpose or function of the organization or entity,

"(v) the property is not transferred by the donee in exchange for money, other property, or services, except for shipping, installation and transfer costs,

"(vi) the property will fit productively into the entity's education plan, and

"(vii) the entity's use and disposition of the property will be in accordance with the provisions of clauses (iv) and (v).

"(C) CONTRIBUTION TO PRIVATE FOUNDATION.—A contribution by a corporation of any computer technology or equipment to a private foundation (as defined in section 509) shall be treated as a qualified elementary or secondary educational contribution for purposes of this paragraph if—

"(i) the contribution to the private foundation satisfies the requirements of clauses (ii) and (v) of subparagraph (B), and

"(ii) within 30 days after such contribution, the private foundation—

"(I) contributes the property to an entity described in clause (i) of subparagraph (B) that satisfies the requirements of clauses (iv) through (vii) of subparagraph (B), and

"(II) notifies the donor of such contribution.

"(D) SPECIAL RULE RELATING TO CONSTRUCTION OF PROPERTY.—For the purposes of this paragraph, the rules of paragraph (4)(C) shall apply.

"(E) DEFINITIONS.—For the purposes of this paragraph—

"(i) COMPUTER TECHNOLOGY OR EQUIPMENT.—The term 'computer technology or equipment' means computer software (as defined by section 197(e)(3)(B)), computer or peripheral equipment (as defined by section 168(i)(2)(B)), and fiber optic cable related to computer use.

"(ii) CORPORATION.—The term 'corporation' has the meaning given to such term by paragraph (4)(D).

"(F) TERMINATION.—This paragraph shall not apply to any contribution made during any taxable year beginning after December 31, 1999.".

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

SEC. 225. TREATMENT OF CANCELLATION OF CERTAIN STUDENT LOANS.

(a) CERTAIN LOANS BY EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Paragraph (2) of section 108(f) (defining student loan) is amended by striking "or" at the end of subpara-

graph (B) and by striking subparagraph (D) and inserting the following:

"(D) any educational organization described in section 170(b)(1)(A)(ii) if such loan is made—

"(i) pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization, or

"(ii) pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a).

The term 'student loan' includes any loan made by an educational organization so described or by an organization exempt from tax under section 501(a) to refinance a loan meeting the requirements of the preceding sentence.".

(2) EXCEPTION FOR DISCHARGES ON ACCOUNT OF SERVICES PERFORMED FOR CERTAIN LENDERS.—Subsection (f) of section 108 is amended by adding at the end the following new paragraph:

"(3) EXCEPTION FOR DISCHARGES ON ACCOUNT OF SERVICES PERFORMED FOR CERTAIN LENDERS.—Paragraph (1) shall not apply to the discharge of a loan made by an organization described in paragraph (2)(D) (or by an organization described in paragraph (2)(E) from funds provided by an organization described in paragraph (2)(D)) if the discharge is on account of services performed for either such organization.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to discharges of indebtedness after the date of the enactment of this Act.

SEC. 226. INCENTIVES FOR EDUCATION ZONES.

(a) IN GENERAL.—Subchapter U of chapter 1 (relating to additional incentives for empowerment zones) is amended by redesignating part IV as part V, by redesignating section 1397E as section 1397F, and by inserting after part III the following new part:

"PART IV—INCENTIVES FOR EDUCATION ZONES

"SEC. 1397E. CREDIT TO HOLDERS OF QUALIFIED ZONE ACADEMY BONDS.

"(a) ALLOWANCE OF CREDIT.—In the case of an eligible taxpayer who holds a qualified zone academy bond on the credit allowance date of such bond which occurs during the taxable year, there shall be allowed as a credit against the tax imposed by this chapter for such taxable year the amount determined under subsection (b).

"(b) AMOUNT OF CREDIT.—

“(1) IN GENERAL.—The amount of the credit determined under this subsection with respect to any qualified zone academy bond is the amount equal to the product of—

“(A) the credit rate determined by the Secretary under paragraph (2) for the month in which such bond was issued, multiplied by

“(B) the face amount of the bond held by the taxpayer on the credit allowance date.

“(2) DETERMINATION.—During each calendar month, the Secretary shall determine a credit rate which shall apply to bonds issued during the following calendar month. The credit rate for any month is the percentage which the Secretary estimates will permit the issuance of qualified zone academy bonds without discount and without interest cost to the issuer.

“(c) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess of—

“(1) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

“(2) the sum of the credits allowable under part IV of subchapter A (other than subpart C thereof, relating to refundable credits).

“(d) QUALIFIED ZONE ACADEMY BOND.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified zone academy bond’ means any bond issued as part of an issue if—

“(A) 95 percent or more of the proceeds of such issue are to be used for a qualified purpose with respect to a qualified zone academy established by an eligible local education agency,

“(B) the bond is issued by a State or local government within the jurisdiction of which such academy is located,

“(C) the issuer—

“(i) designates such bond for purposes of this section,

“(ii) certifies that it has written assurances that the private business contribution requirement of paragraph (2) will be met with respect to such academy, and

“(iii) certifies that it has the written approval of the eligible local education agency for such bond issuance, and

“(D) the term of each bond which is part of such issue does not exceed the maximum term permitted under paragraph (3).

“(2) PRIVATE BUSINESS CONTRIBUTION REQUIREMENT.—

“(A) IN GENERAL.—For purposes of paragraph (1), the private business contribution requirement of this paragraph is met with respect to any issue if the eligible local education agency that established the qualified zone academy has written commitments from private entities to make qualified contributions having a present value (as of the date of issuance of the issue) of not less than 10 percent of the proceeds of the issue.

"(B) QUALIFIED CONTRIBUTIONS.—For purposes of subparagraph (A), the term 'qualified contribution' means any contribution (of a type and quality acceptable to the eligible local education agency) of—

"(i) equipment for use in the qualified zone academy (including state-of-the-art technology and vocational equipment),

"(ii) technical assistance in developing curriculum or in training teachers in order to promote appropriate market driven technology in the classroom,

"(iii) services of employees as volunteer mentors,

"(iv) internships, field trips, or other educational opportunities outside the academy for students, or

"(v) any other property or service specified by the eligible local education agency.

"(3) TERM REQUIREMENT.—During each calendar month, the Secretary shall determine the maximum term permitted under this paragraph for bonds issued during the following calendar month. Such maximum term shall be the term which the Secretary estimates will result in the present value of the obligation to repay the principal on the bond being equal to 50 percent of the face amount of the bond. Such present value shall be determined using as a discount rate the average annual interest rate of tax-exempt obligations having a term of 10 years or more which are issued during the month. If the term as so determined is not a multiple of a whole year, such term shall be rounded to the next highest whole year.

"(4) QUALIFIED ZONE ACADEMY.—

"(A) IN GENERAL.—The term 'qualified zone academy' means any public school (or academic program within a public school) which is established by and operated under the supervision of an eligible local education agency to provide education or training below the postsecondary level if—

"(i) such public school or program (as the case may be) is designed in cooperation with business to enhance the academic curriculum, increase graduation and employment rates, and better prepare students for the rigors of college and the increasingly complex workforce,

"(ii) students in such public school or program (as the case may be) will be subject to the same academic standards and assessments as other students educated by the eligible local education agency,

"(iii) the comprehensive education plan of such public school or program is approved by the eligible local education agency, and

"(iv)(I) such public school is located in an empowerment zone or enterprise community (including any such zone or community designated after the date of the enactment of this section), or

"(II) there is a reasonable expectation (as of the date of issuance of the bonds) that at least 35 percent of the students attending such school or participating in such program (as the case may be) will be eligible

for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

"(B) ELIGIBLE LOCAL EDUCATION AGENCY.—The term 'eligible local education agency' means any local education agency as defined in section 14101 of the Elementary and Secondary Education Act of 1965.

"(5) QUALIFIED PURPOSE.—The term 'qualified purpose' means, with respect to any qualified zone academy—

"(A) rehabilitating or repairing the public school facility in which the academy is established,

"(B) providing equipment for use at such academy,

"(C) developing course materials for education to be provided at such academy, and

"(D) training teachers and other school personnel in such academy.

"(6) ELIGIBLE TAXPAYER.—The term 'eligible taxpayer' means—

"(A) a bank (within the meaning of section 581),

"(B) an insurance company to which subchapter L applies, and

"(C) a corporation actively engaged in the business of lending money.

"(e) LIMITATION ON AMOUNT OF BONDS DESIGNATED.—

"(1) NATIONAL LIMITATION.—There is a national zone academy bond limitation for each calendar year. Such limitation is $400,000,000 for 1998 and 1999, and, except as provided in paragraph (4), zero thereafter.

"(2) ALLOCATION OF LIMITATION.—The national zone academy bond limitation for a calendar year shall be allocated by the Secretary among the States on the basis of their respective populations of individuals below the poverty line (as defined by the Office of Management and Budget). The limitation amount allocated to a State under the preceding sentence shall be allocated by the State education agency to qualified zone academies within such State.

"(3) DESIGNATION SUBJECT TO LIMITATION AMOUNT.—The maximum aggregate face amount of bonds issued during any calendar year which may be designated under subsection (d)(1) with respect to any qualified zone academy shall not exceed the limitation amount allocated to such academy under paragraph (2) for such calendar year.

"(4) CARRYOVER OF UNUSED LIMITATION.—If for any calendar year—

"(A) the limitation amount for any State, exceeds

"(B) the amount of bonds issued during such year which are designated under subsection (d)(1) with respect to qualified zone academies within such State,

the limitation amount for such State for the following calendar year shall be increased by the amount of such excess.

"(f) OTHER DEFINITIONS.—For purposes of this section—

"(1) CREDIT ALLOWANCE DATE.—The term 'credit allowance date' means, with respect to any issue, the last day of the 1-year

period beginning on the date of issuance of such issue and the last day of each successive 1-year period thereafter.

"(2) BOND.—The term 'bond' includes any obligation.

"(3) STATE.—The term 'State' includes the District of Columbia and any possession of the United States.

"(g) CREDIT INCLUDED IN GROSS INCOME.—Gross income includes the amount of the credit allowed to the taxpayer under this section."

(b) CONFORMING AMENDMENTS.—

(1) The table of parts for subchapter U of chapter 1 is amended by striking the last item and inserting the following:

"Part IV. Incentives for education zones.
"Part V. Regulations."

(2) The table of sections for part V, as so redesignated, is amended to read as follows:

"Sec. 1397F. Regulations."

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

TITLE III—SAVINGS AND INVESTMENT INCENTIVES

Subtitle A—Retirement Savings

SEC. 301. RESTORATION OF IRA DEDUCTION FOR CERTAIN TAXPAYERS.

(a) INCREASE IN INCOME LIMITS APPLICABLE TO ACTIVE PARTICIPANTS.—

(1) IN GENERAL.—Subparagraph (B) of section 219(g)(3) (relating to applicable dollar amount) is amended to read as follows:

"(B) APPLICABLE DOLLAR AMOUNT.—The term 'applicable dollar amount' means the following:

"(i) In the case of a taxpayer filing a joint return:

"For taxable years beginning in:	***The applicable dollar amount is:***
1998	*$50,000*
1999	*$51,000*
2000	*$52,000*
2001	*$53,000*
2002	*$54,000*
2003	*$60,000*
2004	*$65,000*
2005	*$70,000*
2006	*$75,000*
2007 and thereafter	*$80,000.*

"(ii) In the case of any other taxpayer (other than a married individual filing a separate return):

"For taxable years beginning in:	***The applicable dollar amount is:***
1998	*$30,000*
1999	*$31,000*
2000	*$32,000*
2001	*$33,000*

2002	*$34,000*
2003	*$40,000*
2004	*$45,000*
2005 and thereafter	*$50,000.*

"(iii) In the case of a married individual filing a separate return, zero.".

(2) INCREASE IN PHASE-OUT RANGE FOR JOINT RETURNS.—Clause (ii) of section 219(g)(2)(A) is amended by inserting "($20,000 in the case of a joint return for a taxable year beginning after December 31, 2006)".

(b) LIMITATIONS FOR ACTIVE PARTICIPATION NOT BASED ON SPOUSE'S PARTICIPATION.—Section 219(g) (relating to limitation on deduction for active participants in certain pension plans) is amended—

(1) by striking "or the individual's spouse" in paragraph (1), and

(2) by adding at the end the following new paragraph:

"(7) SPECIAL RULE FOR CERTAIN SPOUSES.—In the case of an individual who is an active participant at no time during any plan year ending with or within the taxable year but whose spouse is an active participant for any part of any such plan year—

"(A) the applicable dollar amount under paragraph (3)(B)(i) with respect to the taxpayer shall be $150,000, and

"(B) the amount applicable under paragraph (2)(A)(ii) shall be $10,000."

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

SEC. 302. ESTABLISHMENT OF NONDEDUCTIBLE TAX-FREE INDIVIDUAL RETIREMENT ACCOUNTS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to pension, profit-sharing, stock bonus plans, etc.) is amended by inserting after section 408 the following new section:

"SEC. 408A. ROTH IRAS.

"(a) GENERAL RULE.—Except as provided in this section, a Roth IRA shall be treated for purposes of this title in the same manner as an individual retirement plan.

"(b) ROTH IRA.—For purposes of this title, the term 'Roth IRA' means an individual retirement plan (as defined in section 7701(a)(37)) which is designated (in such manner as the Secretary may prescribe) at the time of establishment of the plan as a Roth IRA. Such designation shall be made in such manner as the Secretary may prescribe.

"(c) TREATMENT OF CONTRIBUTIONS.—

"(1) NO DEDUCTION ALLOWED.—No deduction shall be allowed under section 219 for a contribution to a Roth IRA.

"(2) CONTRIBUTION LIMIT.—The aggregate amount of contributions for any taxable year to all Roth IRAs maintained for the benefit of an individual shall not exceed the excess (if any) of—

"(A) the maximum amount allowable as a deduction under section 219 with respect to such individual for such taxable year (computed without regard to subsection (d)(1) or (g) of such section), over

“(B) the aggregate amount of contributions for such taxable year to all other individual retirement plans (other than Roth IRAs) maintained for the benefit of the individual.

“(3) LIMITS BASED ON MODIFIED ADJUSTED GROSS INCOME.—

“(A) DOLLAR LIMIT.—The amount determined under paragraph (2) for any taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to such amount as—

“(i) the excess of—

“(I) the taxpayer’s adjusted gross income for such taxable year, over

“(II) the applicable dollar amount, bears to

“(ii) $15,000 ($10,000 in the case of a joint return).

The rules of subparagraphs (B) and (C) of section 219(g)(2) shall apply to any reduction under this subparagraph.

“(B) ROLLOVER FROM IRA.—A taxpayer shall not be allowed to make a qualified rollover contribution to a Roth IRA from an individual retirement plan other than a Roth IRA during any taxable year if—

“(i) the taxpayer’s adjusted gross income for such taxable year exceeds $100,000, or

“(ii) the taxpayer is a married individual filing a separate return.

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

“(i) adjusted gross income shall be determined in the same manner as under section 219(g)(3), except that any amount included in gross income under subsection (d)(3) shall not be taken into account and the deduction under section 219 shall be taken into account, and

“(ii) the applicable dollar amount is—

“(I) in the case of a taxpayer filing a joint return, $150,000,

“(II) in the case of any other taxpayer (other than a married individual filing a separate return), $95,000, and

“(III) in the case of a married individual filing a separate return, zero.

“(D) MARITAL STATUS.—Section 219(g)(4) shall apply for purposes of this paragraph.

“(4) CONTRIBUTIONS PERMITTED AFTER AGE 70½.—Contributions to a Roth IRA may be made even after the individual for whom the account is maintained has attained age 70½.

“(5) MANDATORY DISTRIBUTION RULES NOT TO APPLY BEFORE DEATH.—Notwithstanding subsections (a)(6) and (b)(3) of section 408 (relating to required distributions), the following provisions shall not apply to any Roth IRA:

“(A) Section 401(a)(9)(A).

“(B) The incidental death benefit requirements of section 401(a).

“(6) ROLLOVER CONTRIBUTIONS.—

"(A) IN GENERAL.—No rollover contribution may be made to a Roth IRA unless it is a qualified rollover contribution.

"(B) COORDINATION WITH LIMIT.—A qualified rollover contribution shall not be taken into account for purposes of paragraph (2).

"(7) TIME WHEN CONTRIBUTIONS MADE.—For purposes of this section, the rule of section 219(f)(3) shall apply.

"(d) DISTRIBUTION RULES.—For purposes of this title—

"(1) GENERAL RULES.—

"(A) EXCLUSIONS FROM GROSS INCOME.—Any qualified distribution from a Roth IRA shall not be includible in gross income.

"(B) NONQUALIFIED DISTRIBUTIONS.—In applying section 72 to any distribution from a Roth IRA which is not a qualified distribution, such distribution shall be treated as made from contributions to the Roth IRA to the extent that such distribution, when added to all previous distributions from the Roth IRA, does not exceed the aggregate amount of contributions to the Roth IRA.

"(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) CERTAIN DISTRIBUTIONS WITHIN 5 YEARS.—A payment or distribution shall not be treated as a qualified distribution under subparagraph (A) 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 a Roth IRA (or such individual's spouse made a contribution to a Roth IRA) established for such individual, or

"(ii) in the case of a payment or distribution properly allocable (as determined in the manner prescribed by the Secretary) to a qualified rollover contribution from an individual retirement plan other than a Roth IRA (or income allocable thereto), it is made within the 5-taxable year period beginning with the taxable year in which the rollover contribution was made.

"(3) ROLLOVERS FROM AN IRA OTHER THAN A ROTH IRA.—

"(A) IN GENERAL.—Notwithstanding section 408(d)(3), in the case of any distribution to which this paragraph applies—

"(i) there shall be included in gross income any amount which would be includible were it not part of a qualified rollover contribution,

"(ii) section 72(t) shall not apply, and

"(iii) in the case of a distribution before January 1, 1999, 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.

"(B) DISTRIBUTIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to a distribution from an individual retirement plan (other than a Roth IRA) maintained for the benefit of an individual which is contributed to a Roth IRA maintained for the benefit of such individual in a qualified rollover contribution.

"(C) CONVERSIONS.—The conversion of an individual retirement plan (other than a Roth IRA) to a Roth IRA shall be treated for purposes of this paragraph as a distribution to which this paragraph applies.

"(D) CONVERSION OF EXCESS CONTRIBUTIONS.—If, no later than the due date for filing the return of tax for any taxable year (without regard to extensions), an individual transfers, from an individual retirement plan (other than a Roth IRA), contributions for such taxable year (and any earnings allocable thereto) to a Roth IRA, no such amount shall be includible in gross income to the extent no deduction was allowed with respect to such amount.

"(E) ADDITIONAL REPORTING REQUIREMENTS.—Trustees of Roth IRAs, trustees of individual retirement plans, or both, whichever is appropriate, shall include such additional information in reports required under section 408(i) as the Secretary may require to ensure that amounts required to be included in gross income under subparagraph (A) are so included.

"(4) COORDINATION WITH INDIVIDUAL RETIREMENT ACCOUNTS.—Section 408(d)(2) shall be applied separately with respect to Roth IRAs and other individual retirement plans.

"(5) QUALIFIED SPECIAL PURPOSE DISTRIBUTION.—For purposes of this section, the term 'qualified special purpose distribution' means any distribution to which subparagraph (F) of section 72(t)(2) applies.

"(e) QUALIFIED ROLLOVER CONTRIBUTION.—For purposes of this section, the term 'qualified rollover contribution' means a rollover contribution to a Roth IRA from another such account, or from an individual retirement plan, but only if such rollover contribution meets the requirements of section 408(d)(3). For purposes of section 408(d)(3)(B), there shall be disregarded any qualified rollover contribution from an individual retirement plan (other than a Roth IRA) to a Roth IRA.".

(b) EXCESS CONTRIBUTIONS.—Section 4973(b), as amended by title II, is amended by adding at the end the following new subsection:

"(f) EXCESS CONTRIBUTIONS TO ROTH IRAS.—For purposes of this section, in the case of contributions to a Roth IRA (within the meaning of section 408A(b)), the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to such accounts (other than a qualified rollover contribution described in section 408A(e)), over

"(B) the amount allowable as a contribution under sections 408A (c)(2) and (c)(3), and

"(2) the amount determined under this subsection for the preceding taxable year, reduced by the sum of—

"(A) the distributions out of the accounts for the taxable year, and

"(B) the excess (if any) of the maximum amount allowable as a contribution under sections 408A (c)(2) and (c)(3) for the taxable year over the amount contributed to the accounts for the taxable year.

For purposes of this subsection, any contribution which is distributed from a Roth IRA in a distribution described in section 408(d)(4) shall be treated as an amount not contributed."

(c) SPOUSAL IRA.—Clause (ii) of section 219(c)(1)(B) is amended to read as follows:

"(ii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by—

"(I) the amount allowed as a deduction under subsection (a) to such spouse for such taxable year, and

"(II) the amount of any contribution on behalf of such spouse to a Roth IRA under section 408A for such taxable year.".

(d) AUTHORITY TO PRESCRIBE NECESSARY REPORTING.—Section 408(i) is amended—

(1) by striking "under regulations", and

(2) by striking "in such regulations" each place it appears.

(e) CONFORMING AMENDMENT.—The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 408 the following new item:

"Sec. 408A. Roth IRAs.".

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

SEC. 303. DISTRIBUTIONS FROM CERTAIN PLANS MAY BE USED WITHOUT PENALTY TO PURCHASE FIRST HOMES.

(a) IN GENERAL.—Paragraph (2) of section 72(t) (relating to exceptions to 10-percent additional tax on early distributions from qualified retirement plans), as amended by section 203, is amended by adding at the end the following new subparagraph:

"(F) DISTRIBUTIONS FROM CERTAIN PLANS FOR FIRST HOME PURCHASES.—Distributions to an individual from an individual retirement plan which are qualified first-time homebuyer distributions (as defined in paragraph (8)). Distributions shall not be taken into account under the preceding sentence if such distributions are described in subparagraph (A), (C), (D), or (E) or to the extent paragraph (1) does not apply to such distributions by reason of subparagraph (B).".

(b) DEFINITIONS.—Section 72(t), as amended by section 203, is amended by adding at the end the following new paragraphs:

“(8) QUALIFIED FIRST-TIME HOMEBUYER DISTRIBUTIONS.—For purposes of paragraph (2)(F)—

“(A) IN GENERAL.—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 120th day after the day on which such payment or distribution is received to pay qualified acquisition costs with respect to a principal residence of a first-time homebuyer who is such individual, the spouse of such individual, or any child, grandchild, or ancestor of such individual or the individual’s spouse.

“(B) LIFETIME DOLLAR LIMITATION.—The aggregate amount of payments or distributions received by an individual which may be treated as qualified first-time homebuyer distributions for any taxable year shall not exceed the excess (if any) of—

“(i) $10,000, over

“(ii) the aggregate amounts treated as qualified first-time homebuyer distributions with respect to such individual for all prior taxable years.

“(C) 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.

“(D) FIRST-TIME HOMEBUYER; OTHER DEFINITIONS.—For purposes of this paragraph—

“(i) FIRST-TIME HOMEBUYER.—The term ‘first-time homebuyer’ means any individual if—

“(I) such individual (and if married, such individual’s spouse) had no present ownership interest in a principal residence during the 2-year period ending on the date of acquisition of the principal residence to which this paragraph applies, and

“(II) subsection (h) or (k) of section 1034 (as in effect on the day before the date of the enactment of this paragraph) did not suspend the running of any period of time specified in section 1034 (as so in effect) with respect to such individual on the day before the date the distribution is applied pursuant to subparagraph (A).

“(ii) PRINCIPAL RESIDENCE.—The term ‘principal residence’ has the same meaning as when used in section 121.

“(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 construction or reconstruction of such a principal residence is commenced.

"(E) SPECIAL RULE WHERE DELAY IN ACQUISITION.—If any distribution from any individual retirement plan fails to meet the requirements of subparagraph (A) solely by reason of a delay or cancellation of the purchase or construction of the residence, the amount of the distribution may be contributed to an individual retirement plan as provided in section 408(d)(3)(A)(i) (determined by substituting '120 days' for '60 days' in such section), except that—

"(i) section 408(d)(3)(B) shall not be applied to such contribution, and

"(ii) such amount shall not be taken into account in determining whether section 408(d)(3)(B) applies to any other amount.".

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

SEC. 304. CERTAIN BULLION NOT TREATED AS COLLECTIBLES.

(a) IN GENERAL.—Paragraph (3) of section 408(m) (relating to exception for certain coins) is amended to read as follows:

"(3) EXCEPTION FOR CERTAIN COINS AND BULLION.—For purposes of this subsection, the term 'collectible' shall not include—

"(A) any coin which is—

"(i) a gold coin described in paragraph (7), (8), (9), or (10) of section 5112(a) of title 31, United States Code,

"(ii) a silver coin described in section 5112(e) of title 31, United States Code,

"(iii) a platinum coin described in section 5112(k) of title 31, United States Code, or

"(iv) a coin issued under the laws of any State, or

"(B) any gold, silver, platinum, or palladium bullion of a fineness equal to or exceeding the minimum fineness that a contract market (as described in section 7 of the Commodity Exchange Act, 7 U.S.C. 7) requires for metals which may be delivered in satisfaction of a regulated futures contract,

if such bullion is in the physical possession of a trustee described under subsection (a) of this section.".

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

Subtitle B—Capital Gains

SEC. 311. MAXIMUM CAPITAL GAINS RATES FOR INDIVIDUALS.

(a) IN GENERAL.—Subsection (h) of section 1 (relating to maximum capital gains rate) is amended to read as follows:

"(h) MAXIMUM CAPITAL GAINS RATE.—

"(1) IN GENERAL.—If a taxpayer has a net capital gain for any taxable year, the tax imposed by this section for such taxable year shall not exceed the sum of—

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

"(i) taxable income reduced by the net capital gain, or

"(ii) the lesser of—

"(I) the amount of taxable income taxed at a rate below 28 percent, or

"(II) taxable income reduced by the adjusted net capital gain, plus

"(B) 25 percent of the excess (if any) of—

"(i) the unrecaptured section 1250 gain (or, if less, the net capital gain), over

"(ii) the excess (if any) of—

"(I) the sum of the amount on which tax is determined under subparagraph (A) plus the net capital gain, over

"(II) taxable income, plus

"(C) 28 percent of the amount of taxable income in excess of the sum of—

"(i) the adjusted net capital gain, plus

"(ii) the sum of the amounts on which tax is determined under subparagraphs (A) and (B), plus

"(D) 10 percent of so much of the taxpayer's adjusted net capital gain (or, if less, taxable income) as does not exceed the excess (if any) of—

"(i) the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 28 percent, over

"(ii) the taxable income reduced by the adjusted net capital gain, plus

"(E) 20 percent of the taxpayer's adjusted net capital gain (or, if less, taxable income) in excess of the amount on which a tax is determined under subparagraph (D).

"(2) REDUCED CAPITAL GAIN RATES FOR QUALIFIED 5-YEAR GAIN.—

"(A) REDUCTION IN 10-PERCENT RATE.—In the case of any taxable year beginning after December 31, 2000, the rate under paragraph (1)(D) shall be 8 percent with respect to so much of the amount to which the 10-percent rate would otherwise apply as does not exceed qualified 5-year gain, and 10 percent with respect to the remainder of such amount.

"(B) REDUCTION IN 20-PERCENT RATE.—The rate under paragraph (1)(E) shall be 18 percent with respect to so much of the amount to which the 20-percent rate would otherwise apply as does not exceed the lesser of—

"(i) the excess of qualified 5-year gain over the amount of such gain taken into account under subparagraph (A) of this paragraph, or

"(ii) the amount of qualified 5-year gain (determined by taking into account only property the holding period for which begins after December 31, 2000),

and 20 percent with respect to the remainder of such amount. For purposes of determining under the preceding sentence whether the holding period of property begins after December 31, 2000, the holding period of property acquired pursuant to the exercise of an option (or other right or obligation to acquire property) shall include the period such option (or other right or obligation) was held.

"(3) NET CAPITAL GAIN TAKEN INTO ACCOUNT AS INVESTMENT INCOME.—For purposes of this subsection, 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).

"(4) ADJUSTED NET CAPITAL GAIN.—For purposes of this subsection, the term 'adjusted net capital gain' means net capital gain determined without regard to—

"(A) collectibles gain,

"(B) unrecaptured section 1250 gain,

"(C) section 1202 gain, and

"(D) mid-term gain.

"(5) COLLECTIBLES GAIN.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'collectibles gain' means gain from the sale or exchange of a collectible (as defined in section 408(m) without regard to paragraph (3) thereof) which is a capital asset held for more than 1 year but only to the extent such gain is taken into account in computing gross income.

"(B) PARTNERSHIPS, ETC.—For purposes of subparagraph (A), any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751 shall apply for purposes of the preceding sentence.

"(6) UNRECAPTURED SECTION 1250 GAIN.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'unrecaptured section 1250 gain' means the amount of long-term capital gain which would be treated as ordinary income if—

"(i) section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, and

"(ii) in the case of gain properly taken into account after July 28, 1997, only gain from section 1250 property held for more than 18 months were taken into account.

"(B) LIMITATION WITH RESPECT TO SECTION 1231 PROPERTY.—The amount of unrecaptured section 1250 gain from sales, exchanges, and conversions described in section 1231(a)(3)(A) for any taxable year shall not exceed the excess of the net section 1231 gain (as defined in section 1231(c)(3)) for such year over the amount treated as ordinary income under section 1231(c)(1) for such year.

"(C) PRE-MAY 7, 1997, GAIN.—In the case of a taxable year which includes May 7, 1997, subparagraph (A) shall

be applied by taking into account only the gain properly taken into account for the portion of the taxable year after May 6, 1997.

"(7) SECTION 1202 GAIN.—For purposes of this subsection, the term 'section 1202 gain' means an amount equal to the gain excluded from gross income under section 1202(a).

"(8) MID-TERM GAIN.—For purposes of this subsection, the term 'mid-term gain' means the amount which would be adjusted net capital gain for the taxable year if—

"(A) adjusted net capital gain were determined by taking into account only the gain or loss properly taken into account after July 28, 1997, from property held for more than 1 year but not more than 18 months, and

"(B) paragraph (3) and section 1212 did not apply.

"(9) QUALIFIED 5-YEAR GAIN.—For purposes of this subsection, the term 'qualified 5-year gain' means the amount of long-term capital gain which would be computed for the taxable year if only gains from the sale or exchange of property held by the taxpayer for more than 5 years were taken into account. The determination under the preceding sentence shall be made without regard to collectibles gain, unrecaptured section 1250 gain (determined without regard to subparagraph (B) of paragraph (6)), section 1202 gain, or mid-term gain.

"(10) PRE-EFFECTIVE DATE GAIN.—

"(A) IN GENERAL.—In the case of a taxable year which includes May 7, 1997, gains and losses properly taken into account for the portion of the taxable year before May 7, 1997, shall be taken into account in determining mid-term gain as if such gains and losses were described in paragraph (8)(A).

"(B) SPECIAL RULES FOR PASS-THRU ENTITIES.—In applying subparagraph (A) with respect to any pass-thru entity, the determination of when gains and loss are properly taken into account shall be made at the entity level.

"(C) PASS-THRU ENTITY DEFINED.—For purposes of subparagraph (B), 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.

"(11) TREATMENT OF PASS-THRU ENTITIES.—The Secretary may prescribe such regulations as are appropriate (including regulations requiring reporting) to apply this subsection in the case of sales and exchanges by pass-thru entities (as defined in paragraph (10)(C)) and of interests in such entities.".

(b) MINIMUM TAX.—

(1) IN GENERAL.—Subsection (b) of section 55 is amended by adding at the end the following new paragraph:

"(3) MAXIMUM RATE OF TAX ON NET CAPITAL GAIN OF NONCORPORATE TAXPAYERS.—The amount determined under the first sentence of paragraph (1)(A)(i) shall not exceed the sum of—

"(A) the amount determined under such first sentence computed at the rates and in the same manner as if this paragraph had not been enacted on the taxable excess reduced by the lesser of—

"(i) the net capital gain, or

"(ii) the sum of—

"(I) the adjusted net capital gain, plus

"(II) the unrecaptured section 1250 gain, plus

"(B) 25 percent of the lesser of—

"(i) the unrecaptured section 1250 gain, or

"(ii) the amount of taxable excess in excess of the sum of—

"(I) the adjusted net capital gain, plus

"(II) the amount on which a tax is determined under subparagraph (A), plus

"(C) 10 percent of so much of the taxpayer's adjusted net capital gain (or, if less, taxable excess) as does not exceed the amount on which a tax is determined under section 1(h)(1)(D), plus

"(D) 20 percent of the taxpayer's adjusted net capital gain (or, if less, taxable excess) in excess of the amount on which tax is determined under subparagraph (C).

In the case of taxable years beginning after December 31, 2000, rules similar to the rules of section 1(h)(2) shall apply for purposes of subparagraphs (C) and (D). Terms used in this paragraph which are also used in section 1(h) shall have the respective meanings given such terms by section 1(h).".

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 55(b)(1)(A) is amended by striking "clause (i)" and inserting "this subsection".

(B) Paragraph (7) of section 57(a) is amended by striking "one-half" and inserting "42 percent".

(c) OTHER CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 1445(e) is amended by striking "28 percent" and inserting "20 percent".

(2) The second sentence of section 7518(g)(6)(A), and the second sentence of section 607(h)(6)(A) of the Merchant Marine Act, 1936, are each amended by striking "28 percent" and inserting "20 percent".

(3) Paragraph (2) of section 904(b) is amended by adding at the end the following new subparagraph:

"(C) COORDINATION WITH CAPITAL GAINS RATES.—The Secretary may by regulations modify the application of this paragraph and paragraph (3) to the extent necessary to properly reflect any capital gain rate differential under section 1(h) or 1201(a) and the computation of net capital gain.".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years ending after May 6, 1997.

(2) WITHHOLDING.—The amendment made by subsection (c)(1) shall apply only to amounts paid after the date of the enactment of this Act.

(e) ELECTION TO RECOGNIZE GAIN ON ASSETS HELD ON JANUARY 1, 2001.—For purposes of the Internal Revenue Code of 1986—

(1) IN GENERAL.—A taxpayer other than a corporation may elect to treat—

(A) any readily tradable stock (which is a capital asset) held by such taxpayer on January 1, 2001, and not sold before the next business day after such date, as having been sold on such next business day for an amount equal to its closing market price on such next business day (and as having been reacquired on such next business day for an amount equal to such closing market price), and

(B) any other capital asset or property used in the trade or business (as defined in section 1231(b) of the Internal Revenue Code of 1986) held by the taxpayer on January 1, 2001, as having been sold on such date for an amount equal to its fair market value on such date (and as having been reacquired on such date for an amount equal to such fair market value).

(2) TREATMENT OF GAIN OR LOSS.—

(A) Any gain resulting from an election under paragraph (1) shall be treated as received or accrued on the date the asset is treated as sold under paragraph (1) and shall be recognized notwithstanding any provision of the Internal Revenue Code of 1986.

(B) Any loss resulting from an election under paragraph (1) shall not be allowed for any taxable year.

(3) ELECTION.—An election under paragraph (1) shall be made in such manner as the Secretary of the Treasury or his delegate may prescribe and shall specify the assets for which such election is made. Such an election, once made with respect to any asset, shall be irrevocable.

(4) READILY TRADABLE STOCK.—For purposes of this subsection, the term "readily tradable stock" means any stock which, as of January 1, 2001, is readily tradable on an established securities market or otherwise.

SEC. 312. EXEMPTION FROM TAX FOR GAIN ON SALE OF PRINCIPAL RESIDENCE.

(a) IN GENERAL.—Section 121 (relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55) is amended to read as follows:

"SEC. 121. EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

"(a) EXCLUSION.—Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

"(b) LIMITATIONS.—

"(1) IN GENERAL.—The amount of gain excluded from gross income under subsection (a) with respect to any sale or exchange shall not exceed $250,000.

"(2) $500,000 LIMITATION FOR CERTAIN JOINT RETURNS.—Paragraph (1) shall be applied by substituting '$500,000' for '$250,000' if—

"(A) a husband and wife make a joint return for the taxable year of the sale or exchange of the property,

"(B) either spouse meets the ownership requirements of subsection (a) with respect to such property,

"(C) both spouses meet the use requirements of subsection (a) with respect to such property, and

"(D) neither spouse is ineligible for the benefits of subsection (a) with respect to such property by reason of paragraph (3).

"(3) APPLICATION TO ONLY 1 SALE OR EXCHANGE EVERY 2 YEARS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any sale or exchange by the taxpayer if, during the 2-year period ending on the date of such sale or exchange, there was any other sale or exchange by the taxpayer to which subsection (a) applied.

"(B) PRE-MAY 7, 1997, SALES NOT TAKEN INTO ACCOUNT.—Subparagraph (A) shall be applied without regard to any sale or exchange before May 7, 1997.

"(c) EXCLUSION FOR TAXPAYERS FAILING TO MEET CERTAIN REQUIREMENTS.—

"(1) IN GENERAL.—In the case of a sale or exchange to which this subsection applies, the ownership and use requirements of subsection (a) shall not apply and subsection (b)(3) shall not apply; but the amount of gain excluded from gross income under subsection (a) with respect to such sale or exchange shall not exceed—

"(A) the amount which bears the same ratio to the amount which would be so excluded under this section if such requirements had been met, as

"(B) the shorter of—

"(i) the aggregate periods, during the 5-year period ending on the date of such sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence, or

"(ii) the period after the date of the most recent prior sale or exchange by the taxpayer to which subsection (a) applied and before the date of such sale or exchange,

bears to 2 years.

"(2) SALES AND EXCHANGES TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any sale or exchange if—

"(A) subsection (a) would not (but for this subsection) apply to such sale or exchange by reason of—

"(i) a failure to meet the ownership and use requirements of subsection (a), or

"(ii) subsection (b)(3), and

"(B) such sale or exchange is by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances.

"(d) SPECIAL RULES.—

"(1) JOINT RETURNS.—If a husband and wife make a joint return for the taxable year of the sale or exchange of the property, subsections (a) and (c) shall apply if either spouse meets

the ownership and use requirements of subsection (a) with respect to such property.

"(2) PROPERTY OF DECEASED SPOUSE.—For purposes of this section, in the case of an unmarried individual whose spouse is deceased on the date of the sale or exchange of property, the period such unmarried individual owned and used such property shall include the period such deceased spouse owned and used such property before death.

"(3) PROPERTY OWNED BY SPOUSE OR FORMER SPOUSE.—For purposes of this section—

"(A) PROPERTY TRANSFERRED TO INDIVIDUAL FROM SPOUSE OR FORMER SPOUSE.—In the case of an individual holding property transferred to such individual in a transaction described in section 1041(a), the period such individual owns such property shall include the period the transferor owned the property.

"(B) PROPERTY USED BY FORMER SPOUSE PURSUANT TO DIVORCE DECREE, ETC.—Solely for purposes of this section, an individual shall be treated as using property as such individual's principal residence during any period of ownership while such individual's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)).

"(4) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—For purposes of this section, if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), then—

"(A) the holding requirements of subsection (a) shall be applied to the holding of such stock, and

"(B) the use requirements of subsection (a) shall be applied to the house or apartment which the taxpayer was entitled to occupy as such stockholder.

"(5) INVOLUNTARY CONVERSIONS.—

"(A) IN GENERAL.—For purposes of this section, the destruction, theft, seizure, requisition, or condemnation of property shall be treated as the sale of such property.

"(B) APPLICATION OF SECTION 1033.—In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property shall be treated as being the amount determined without regard to this section, reduced by the amount of gain not included in gross income pursuant to this section.

"(C) PROPERTY ACQUIRED AFTER INVOLUNTARY CONVERSION.—If the basis of the property sold or exchanged is determined (in whole or in part) under section 1033(b) (relating to basis of property acquired through involuntary conversion), then the holding and use by the taxpayer of the converted property shall be treated as holding and use by the taxpayer of the property sold or exchanged.

"(6) RECOGNITION OF GAIN ATTRIBUTABLE TO DEPRECIATION.—Subsection (a) shall not apply to so much of the gain from the sale of any property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3))

attributable to periods after May 6, 1997, in respect of such property.

"(7) DETERMINATION OF USE DURING PERIODS OF OUT-OF-RESIDENCE CARE.—In the case of a taxpayer who—

"(A) becomes physically or mentally incapable of self-care, and

"(B) owns property and uses such property as the taxpayer's principal residence during the 5-year period described in subsection (a) for periods aggregating at least 1 year,

then the taxpayer shall be treated as using such property as the taxpayer's principal residence during any time during such 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

"(8) SALES OF REMAINDER INTERESTS.—For purposes of this section—

"(A) IN GENERAL.—At the election of the taxpayer, this section shall not fail to apply to the sale or exchange of an interest in a principal residence by reason of such interest being a remainder interest in such residence, but this section shall not apply to any other interest in such residence which is sold or exchanged separately.

"(B) EXCEPTION FOR SALES TO RELATED PARTIES.—Subparagraph (A) shall not apply to any sale to, or exchange with, any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

"(e) DENIAL OF EXCLUSION FOR EXPATRIATES.—This section shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) applies to such individual.

"(f) ELECTION TO HAVE SECTION NOT APPLY.—This section shall not apply to any sale or exchange with respect to which the taxpayer elects not to have this section apply.

"(g) RESIDENCES ACQUIRED IN ROLLOVERS UNDER SECTION 1034.—For purposes of this section, in the case of property the acquisition of which by the taxpayer resulted under section 1034 (as in effect on the day before the date of the enactment of this section) in the nonrecognition of any part of the gain realized on the sale or exchange of another residence, in determining the period for which the taxpayer has owned and used such property as the taxpayer's principal residence, there shall be included the aggregate periods for which such other residence (and each prior residence taken into account under section 1223(7) in determining the holding period of such property) had been so owned and used.".

(b) REPEAL OF NONRECOGNITION OF GAIN ON ROLLOVER OF PRINCIPAL RESIDENCE.—Section 1034 (relating to rollover of gain on sale of principal residence) is hereby repealed.

(c) EXCEPTION FROM REPORTING.—Subsection (e) of section 6045 (relating to return required in the case of real estate transactions) is amended by adding at the end the following new paragraph:

"(5) EXCEPTION FOR SALES OR EXCHANGES OF CERTAIN PRINCIPAL RESIDENCES.—

"(A) IN GENERAL.—Paragraph (1) shall not apply to any sale or exchange of a residence for $250,000 or less if the person referred to in paragraph (2) receives written assurance in a form acceptable to the Secretary from the seller that—

"(i) such residence is the principal residence (within the meaning of section 121) of the seller,

"(ii) if the Secretary requires the inclusion on the return under subsection (a) of information as to whether there is federally subsidized mortgage financing assistance with respect to the mortgage on residences, that there is no such assistance with respect to the mortgage on such residence, and

"(iii) the full amount of the gain on such sale or exchange is excludable from gross income under section 121.

If such assurance includes an assurance that the seller is married, the preceding sentence shall be applied by substituting '$500,000' for '$250,000'.

The Secretary may by regulation increase the dollar amounts under this subparagraph if the Secretary determines that such an increase will not materially reduce revenues to the Treasury.

"(B) SELLER.—For purposes of this paragraph, the term 'seller' includes the person relinquishing the residence in an exchange.".

(d) CONFORMING AMENDMENTS.—

(1) The following provisions of the Internal Revenue Code of 1986 are each amended by striking "section 1034" and inserting "section 121": sections 25(e)(7), 56(e)(1)(A), 56(e)(3)(B)(i), 143(i)(1)(C)(i)(I), 163(h)(4)(A)(i)(I), 280A(d)(4)(A), 464(f)(3)(B)(i), 1033(h)(4), 1274(c)(3)(B), 6334(a)(13), and 7872(f)(11)(A).

(2) Paragraph (4) of section 32(c) is amended by striking "(as defined in section 1034(h)(3))" and by adding at the end the following new sentence: "For purposes of the preceding sentence, the term 'extended active duty' means any period of active duty pursuant to a call or order to such duty for a period in excess of 90 days or for an indefinite period.".

(3) Subparagraph (A) of 143(m)(6) is amended by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034(e)".

(4) Subsection (e) of section 216 is amended by striking "such exchange qualifies for nonrecognition of gain under section 1034(f)" and inserting "such dwelling unit is used as his principal residence (within the meaning of section 121)".

(5) Section 512(a)(3)(D) is amended by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034".

(6) Paragraph (7) of section 1016(a) is amended by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034" and by inserting "(as so in effect)" after "1034(e)".

(7) Paragraph (3) of section 1033(k) is amended to read as follows:

"(3) For exclusion from gross income of gain from involuntary conversion of principal residence, see section 121.".

(8) Subsection (e) of section 1038 is amended to read as follows:

"(e) PRINCIPAL RESIDENCES.—If—

"(1) subsection (a) applies to a reacquisition of real property with respect to the sale of which gain was not recognized under section 121 (relating to gain on sale of principal residence); and

"(2) within 1 year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary, subsections (b), (c), and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying section 121, the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.".

(9) Paragraph (7) of section 1223 is amended by inserting "(as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997)" after "1034".

(10)(A) Subsection (d) of section 1250 is amended by striking paragraph (7) and by redesignating paragraphs (9) and (10) as paragraphs (7) and (8), respectively.

(B) Subsection (e) of section 1250 is amended by striking paragraph (3).

(11) Subsection (c) of section 6012 is amended by striking "(relating to one-time exclusion of gain from sale of principal residence by individual who has attained age 55)" and inserting "(relating to gain from sale of principal residence)".

(12) Paragraph (2) of section 6212(c) is amended by striking subparagraph (C) and by redesignating the succeeding subparagraphs accordingly.

(13) Section 6504 is amended by striking paragraph (4) and by redesignating the succeeding paragraphs accordingly.

(14) The item relating to section 121 in the table of sections for part III of subchapter B of chapter 1 is amended to read as follows:

"Sec. 121. Exclusion of gain from sale of principal residence.".

(15) The table of sections for part III of subchapter O of chapter 1 is amended by striking the item relating to section 1034.

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales and exchanges after May 6, 1997.

(2) SALES BEFORE DATE OF ENACTMENT.—At the election of the taxpayer, the amendments made by this section shall not apply to any sale or exchange before the date of the enactment of this Act.

(3) CERTAIN SALES WITHIN 2 YEARS AFTER DATE OF ENACTMENT.—Section 121 of the Internal Revenue Code of 1986 (as amended by this section) shall be applied without regard to subsection (c)(2)(B) thereof in the case of any sale or exchange of property during the 2-year period beginning on the date of the enactment of this Act if the taxpayer held such property on the date of the enactment of this Act and fails to meet the own-

ership and use requirements of subsection (a) thereof with respect to such property.

(4) BINDING CONTRACTS.—At the election of the taxpayer, the amendments made by this section shall not apply to a sale or exchange after the date of the enactment of this Act, if—

(A) such sale or exchange is pursuant to a contract which was binding on such date, or

(B) without regard to such amendments, gain would not be recognized under section 1034 of the Internal Revenue Code of 1986 (as in effect on the day before the date of the enactment of this Act) on such sale or exchange by reason of a new residence acquired on or before such date or with respect to the acquisition of which by the taxpayer a binding contract was in effect on such date.

This paragraph shall not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) of the Internal Revenue Code of 1986 applies to such individual.

SEC. 313. ROLLOVER OF GAIN FROM SALE OF QUALIFIED STOCK.

(a) IN GENERAL.—Part III of subchapter O of chapter 1 is amended by adding at the end the following new section:

"SEC. 1045. ROLLOVER OF GAIN FROM QUALIFIED SMALL BUSINESS STOCK TO ANOTHER QUALIFIED SMALL BUSINESS STOCK.

"(a) NONRECOGNITION OF GAIN.—In the case of any sale of qualified small business stock held by an individual for more than 6 months and with respect to which such individual elects the application of this section, gain from such sale shall be recognized only to the extent that the amount realized on such sale exceeds—

"(1) the cost of any qualified small business stock purchased by the taxpayer during the 60-day period beginning on the date of such sale, reduced by

"(2) any portion of such cost previously taken into account under this section.

This section shall not apply to any gain which is treated as ordinary income for purposes of this title.

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

"(1) QUALIFIED SMALL BUSINESS STOCK.—The term 'qualified small business stock' has the meaning given such term by section 1202(c).

"(2) PURCHASE.—A taxpayer shall be treated as having purchased any property if, but for paragraph (3), the unadjusted basis of such property in the hands of the taxpayer would be its cost (within the meaning of section 1012).

"(3) 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 qualified small business stock which is purchased by the taxpayer during the 60-day period described in subsection (a).

"(4) HOLDING PERIOD.—For purposes of determining whether the nonrecognition of gain under subsection (a) applies to stock which is sold—

"(A) the taxpayer's holding period for such stock and the stock referred to in subsection (a)(1) shall be determined without regard to section 1223, and

"(B) only the first 6 months of the taxpayer's holding period for the stock referred to in subsection (a)(1) shall be taken into account for purposes of applying section 1202(c)(2).".

(b) CONFORMING AMENDMENTS.—

(1) Section 1016(a)(23) is amended—

(A) by striking "or 1044" and inserting ", 1044, or 1045", and

(B) by striking "or 1044(d)" and inserting ", 1044(d), or 1045(b)(4)".

(2) Section 1223 is amended by redesignating paragraph (15) as paragraph (16) and by inserting after paragraph (14) the following new paragraph:

"(15) In determining the period for which the taxpayer has held property the acquisition of which resulted under section 1045 in the nonrecognition of any part of the gain realized on the sale of other property, there shall be included the period for which such other property has been held as of the date of such sale.".

(3) The table of sections for part III of subchapter O of chapter 1 is amended by adding at the end the following new item:

"Sec. 1045. Rollover of gain from qualified small business stock to another qualified small business stock.".

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

SEC. 314. AMOUNT OF NET CAPITAL GAIN TAKEN INTO ACCOUNT IN COMPUTING ALTERNATIVE TAX ON CAPITAL GAINS FOR CORPORATIONS NOT TO EXCEED TAXABLE INCOME OF THE CORPORATION.

(a) IN GENERAL.—Paragraph (2) of section 1201(a) is amended by inserting before the period "(or, if less, taxable income)".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years ending after December 31, 1997.

TITLE IV—ALTERNATIVE MINIMUM TAX REFORM

SEC. 401. EXEMPTION FROM ALTERNATIVE MINIMUM TAX FOR SMALL CORPORATIONS.

(a) IN GENERAL.—Section 55 (relating to alternative minimum tax imposed) is amended by adding at the end the following new subsection:

"(e) EXEMPTION FOR SMALL CORPORATIONS.—

"(1) IN GENERAL.—The tentative minimum tax of a corporation shall be zero for any taxable year if—

"(A) such corporation met the $5,000,000 gross receipts test of section 448(c) for its first taxable year beginning after December 31, 1996, and

"(B) such corporation would meet such test for the taxable year and all prior taxable years beginning after such first taxable year if such test were applied by substituting '$7,500,000' for '$5,000,000'.

"(2) PROSPECTIVE APPLICATION OF MINIMUM TAX IF SMALL CORPORATION CEASES TO BE SMALL.—In the case of a corporation whose tentative minimum tax is zero for any prior taxable year by reason of paragraph (1), the application of this part for taxable years beginning with the first taxable year such corporation ceases to be described in paragraph (1) shall be determined with the following modifications:

"(A) Section 56(a)(1) (relating to depreciation) and section 56(a)(5) (relating to pollution control facilities) shall apply only to property placed in service on or after the change date.

"(B) Section 56(a)(2) (relating to mining exploration and development costs) shall apply only to costs paid or incurred on or after the change date.

"(C) Section 56(a)(3) (relating to treatment of long-term contracts) shall apply only to contracts entered into on or after the change date.

"(D) Section 56(a)(4) (relating to alternative net operating loss deduction) shall apply in the same manner as if, in section 56(d)(2), the change date were substituted for 'January 1, 1987' and the day before the change date were substituted for 'December 31, 1986' each place it appears.

"(E) Section 56(g)(2)(B) (relating to limitation on allowance of negative adjustments based on adjusted current earnings) shall apply only to prior taxable years beginning on or after the change date.

"(F) Section 56(g)(4)(A) (relating to adjustment for depreciation to adjusted current earnings) shall not apply.

"(G) Subparagraphs (D) and (F) of section 56(g)(4) (relating to other earnings and profits adjustments and depletion) shall apply in the same manner as if the day before the change date were substituted for 'December 31, 1989' each place it appears therein.

"(3) EXCEPTION.—The modifications in paragraph (2) shall not apply to—

"(A) any item acquired by the corporation in a transaction to which section 381 applies, and

"(B) any property the basis of which in the hands of the corporation is determined by reference to the basis of the property in the hands of the transferor,

if such item or property was subject to any provision referred to in paragraph (2) while held by the transferor.

"(4) CHANGE DATE.—For purposes of paragraph (2), the change date is the first day of the first taxable year for which the taxpayer ceases to be described in paragraph (1).

"(5) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—In the case of a taxpayer whose tentative minimum tax for any taxable year is zero by reason of paragraph (1), section 53(c) shall be applied for such year by reducing the amount otherwise taken into account under section

53(c)(1) by 25 percent of so much of such amount as exceeds $25,000. Rules similar to the rules of section 38(c)(3)(B) shall apply for purposes of the preceding sentence.".

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

SEC. 402. REPEAL OF SEPARATE DEPRECIATION LIVES FOR MINIMUM TAX PURPOSES.

(a) IN GENERAL.—Clause (i) of section 56(a)(1)(A) is amended by adding at the end the following new sentence: "In the case of property placed in service after December 31, 1998, the preceding sentence shall not apply but clause (ii) shall continue to apply."

(b) POLLUTION CONTROL FACILITIES.—Paragraph (5) of section 56(a) is amended by adding at the end the following new sentence: "In the case of such a facility placed in service after December 31, 1998, such deduction shall be determined under section 168 using the straight line method.".

SEC. 403. MINIMUM TAX NOT TO APPLY TO FARMERS' INSTALLMENT SALES.

(a) IN GENERAL.—Subsection (a) of section 56 is amended by striking paragraph (6) (relating to treatment of installment sales) and by redesignating paragraphs (7) and (8) as paragraphs (6) and (7), respectively.

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by this section shall apply to dispositions in taxable years beginning after December 31, 1987.

(2) SPECIAL RULE FOR 1987.—In the case of taxable years beginning in 1987, the last sentence of section 56(a)(6) of the Internal Revenue Code of 1986 (as in effect for such taxable years) shall be applied by inserting "or in the case of a taxpayer using the cash receipts and disbursements method of accounting, any disposition described in section 453C(e)(1)(B)(ii)" after "section 453C(e)(4)".

TITLE V—ESTATE, GIFT, AND GENERATION-SKIPPING TAX PROVISIONS

Subtitle A—Estate and Gift Tax Provisions

SEC. 501. COST-OF-LIVING ADJUSTMENTS RELATING TO ESTATE AND GIFT TAX PROVISIONS.

(a) INCREASE IN UNIFIED ESTATE AND GIFT TAX CREDIT.—

(1) ESTATE TAX CREDIT.—

(A) IN GENERAL.—Subsection (a) of section 2010 (relating to unified credit against estate tax) is amended by striking "$192,800" and inserting "the applicable credit amount".

(B) APPLICABLE CREDIT AMOUNT.—Section 2010 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) APPLICABLE CREDIT AMOUNT.—For purposes of this section, 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:***
1998	*$ 625,000*
1999	*$ 650,000*
2000 and 2001	*$ 675,000*
2002 and 2003	*$ 700,000*
2004	*$ 850,000*
2005	*$ 950,000*
2006 or thereafter	*$1,000,000."*

(C) ESTATE TAX RETURNS.—Paragraph (1) of section 6018(a) is amended by striking "$600,000" and inserting "the applicable exclusion amount in effect under section 2010(c) for the calendar year which includes the date of death".

(D) PHASEOUT OF GRADUATED RATES AND UNIFIED CREDIT.—Paragraph (2) of section 2001(c) is amended by striking "$21,040,000" and inserting "the amount at which the average tax rate under this section is 55 percent".

(E) ESTATES OF NONRESIDENTS NOT CITIZENS.—Subparagraph (A) of section 2102(c)(3) is amended by striking "$192,800" and inserting "the applicable credit amount in effect under section 2010(c) for the calendar year which includes the date of death".

(2) UNIFIED GIFT TAX CREDIT.—Paragraph (1) of section 2505(a) is amended by striking "$192,800" and inserting "the applicable credit amount in effect under section 2010(c) for such calendar year".

(b) ALTERNATE VALUATION OF CERTAIN FARM, ETC., REAL PROPERTY.—Subsection (a) of section 2032A is amended by adding at the end the following new paragraph:

"(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 next lowest multiple of $10,000.".

(c) ANNUAL GIFT TAX EXCLUSION.—Subsection (b) of section 2503 is amended—

(1) by striking the subsection heading and inserting the following:

"(b) EXCLUSIONS FROM GIFTS.—

"(1) IN GENERAL.—",

(2) by moving the text 2 ems to the right, and

(3) by adding at the end the following new paragraph:

"(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 next lowest multiple of $1,000.".

(d) EXEMPTION FROM GENERATION-SKIPPING TAX.—Section 2631 (relating to GST exemption) is amended by adding at the end the following new subsection:

"(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 next lowest multiple of $10,000.".

(e) AMOUNT SUBJECT TO REDUCED RATE WHERE EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX ON CLOSELY HELD BUSINESS.—Subsection (j) of section 6601 is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) INFLATION ADJUSTMENT.—In the case of estates of decedents dying in a calendar year after 1998, the $1,000,000 amount contained in paragraph (2)(A) shall be increased by an amount equal to—

"(A) $1,000,000, 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 next lowest multiple of $10,000.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to the estates of decedents dying, and gifts made, after December 31, 1997.

SEC. 502. FAMILY-OWNED BUSINESS EXCLUSION.

(a) IN GENERAL.—Part III of subchapter A of chapter 11 (relating to gross estate) is amended by inserting after section 2033 the following new section:

"SEC. 2033A. FAMILY-OWNED BUSINESS EXCLUSION.

"(a) IN GENERAL.—In the case of an estate of a decedent to which this section applies, the value of the gross estate shall not include the lesser of—

"(1) the adjusted value of the qualified family-owned business interests of the decedent otherwise includible in the estate, or

"(2) the excess of $1,300,000 over the applicable exclusion amount under section 2010(c) with respect to such estate.

"(b) ESTATES TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—This section shall apply to an estate if—

"(A) the decedent was (at the date of the decedent's death) a citizen or resident of the United States,

"(B) the executor elects the application of this section and files the agreement referred to in subsection (h),

"(C) the sum of—

"(i) the adjusted value of the qualified family-owned business interests described in paragraph (2), plus

"(ii) the amount of the gifts of such interests determined under paragraph (3),

exceeds 50 percent of the adjusted gross estate, and

"(D) during the 8-year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which—

"(i) such interests were owned by the decedent or a member of the decedent's family, and

"(ii) there was material participation (within the meaning of section 2032A(e)(6)) by the decedent or a member of the decedent's family in the operation of the business to which such interests relate.

"(2) INCLUDIBLE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—The qualified family-owned business interests described in this paragraph are the interests which—

"(A) are included in determining the value of the gross estate (without regard to this section), and

"(B) are acquired by any qualified heir from, or passed to any qualified heir from, the decedent (within the meaning of section 2032A(e)(9)).

"(3) INCLUDIBLE GIFTS OF INTERESTS.—The amount of the gifts of qualified family-owned business interests determined under this paragraph is the excess of—

"(A) the sum of—

"(i) the amount of such gifts from the decedent to members of the decedent's family taken into account under subsection 2001(b)(1)(B), plus

"(ii) the amount of such gifts otherwise excluded under section 2503(b),

to the extent such interests are continuously held by members of such family (other than the decedent's spouse) between the date of the gift and the date of the decedent's death, over

"(B) the amount of such gifts from the decedent to members of the decedent's family otherwise included in the gross estate.

"(c) ADJUSTED GROSS ESTATE.—For purposes of this section, the term 'adjusted gross estate' means the value of the gross estate (determined without regard to this section)—

"(1) reduced by any amount deductible under paragraph (3) or (4) of section 2053(a), and

"(2) increased by the excess of—

"(A) the sum of—

"(i) the amount of gifts determined under subsection (b)(3), plus

"(ii) the amount (if more than de minimis) of other transfers from the decedent to the decedent's spouse (at the time of the transfer) within 10 years of the date of the decedent's death, plus

"(iii) the amount of other gifts (not included under clause (i) or (ii)) from the decedent within 3 years of such date, other than gifts to members of the decedent's family otherwise excluded under section 2503(b), over

"(B) the sum of the amounts described in clauses (i), (ii), and (iii) of subparagraph (A) which are otherwise includible in the gross estate.

For purposes of the preceding sentence, the Secretary may provide that de minimis gifts to persons other than members of the decedent's family shall not be taken into account.

"(d) ADJUSTED VALUE OF THE QUALIFIED FAMILY-OWNED BUSINESS INTERESTS.—For purposes of this section, the adjusted value of any qualified family-owned business interest is the value of such interest for purposes of this chapter (determined without regard to this section), reduced by the excess of—

"(1) any amount deductible under paragraph (3) or (4) of section 2053(a), over

"(2) the sum of—

"(A) any indebtedness on any qualified residence of the decedent the interest on which is deductible under section 163(h)(3), plus

"(B) any indebtedness to the extent the taxpayer establishes that the proceeds of such indebtedness were used for the payment of educational and medical expenses of the decedent, the decedent's spouse, or the decedent's dependents (within the meaning of section 152), plus

"(C) any indebtedness not described in subparagraph (A) or (B), to the extent such indebtedness does not exceed $10,000.

"(e) QUALIFIED FAMILY-OWNED BUSINESS INTEREST.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified family-owned business interest' means—

"(A) an interest as a proprietor in a trade or business carried on as a proprietorship, or

"(B) an interest in an entity carrying on a trade or business, if—

"(i) at least—

"(I) 50 percent of such entity is owned (directly or indirectly) by the decedent and members of the decedent's family,

"(II) 70 percent of such entity is so owned by members of 2 families, or

"(III) 90 percent of such entity is so owned by members of 3 families, and

"(ii) for purposes of subclause (II) or (III) of clause (i), at least 30 percent of such entity is so owned by the decedent and members of the decedent's family.

"(2) LIMITATION.—Such term shall not include—

"(A) any interest in a trade or business the principal place of business of which is not located in the United States,

"(B) any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years of the date of the decedent's death,

"(C) any interest in a trade or business not described in section 542(c)(2), if more than 35 percent of the adjusted ordinary gross income of such trade or business for the taxable year which includes the date of the decedent's death would qualify as personal holding company income (as defined in section 543(a)),

"(D) that portion of an interest in a trade or business that is attributable to—

"(i) cash or marketable securities, or both, in excess of the reasonably expected day-to-day working capital needs of such trade or business, and

"(ii) any other assets of the trade or business (other than assets used in the active conduct of a trade or business described in section 542(c)(2)), which produce, or are held for the production of, income of which is described in section 543(a) or in section 954(c)(1) (determined without regard to subparagraph (A) thereof and by substituting 'trade or business' for 'controlled foreign corporation').

"(3) RULES REGARDING OWNERSHIP.—

"(A) OWNERSHIP OF ENTITIES.—For purposes of paragraph (1)(B)—

"(i) CORPORATIONS.—Ownership of a corporation shall be determined by the holding of stock possessing the appropriate percentage of the total combined voting power of all classes of stock entitled to vote and the appropriate percentage of the total value of shares of all classes of stock.

"(ii) PARTNERSHIPS.—Ownership of a partnership shall be determined by the owning of the appropriate percentage of the capital interest in such partnership.

"(B) OWNERSHIP OF TIERED ENTITIES.—For purposes of this section, if by reason of holding an interest in a trade or business, a decedent, any member of the decedent's fam-

ily, any qualified heir, or any member of any qualified heir's family is treated as holding an interest in any other trade or business—

"(i) such ownership interest in the other trade or business shall be disregarded in determining if the ownership interest in the first trade or business is a qualified family-owned business interest, and

"(ii) this section shall be applied separately in determining if such interest in any other trade or business is a qualified family-owned business interest.

"(C) INDIVIDUAL OWNERSHIP RULES.—For purposes of this section, an interest owned, directly or indirectly, by or for an entity described in paragraph (1)(B) shall be considered as being owned proportionately by or for the entity's shareholders, partners, or beneficiaries. A person shall be treated as a beneficiary of any trust only if such person has a present interest in such trust.

"(f) TAX TREATMENT OF FAILURE TO MATERIALLY PARTICIPATE IN BUSINESS OR DISPOSITIONS OF INTERESTS.—

"(1) IN GENERAL.—There is imposed an additional estate tax if, within 10 years after the date of the decedent's death and before the date of the qualified heir's death—

"(A) the material participation requirements described in section 2032A(c)(6)(B) are not met with respect to the qualified family-owned business interest which was acquired (or passed) from the decedent,

"(B) the qualified heir disposes of any portion of a qualified family-owned business interest (other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution under section 170(h)),

"(C) the qualified heir loses United States citizenship (within the meaning of section 877) or with respect to whom an event described in subparagraph (A) or (B) of section 877(e)(1) occurs, and such heir does not comply with the requirements of subsection (g), or

"(D) the principal place of business of a trade or business of the qualified family-owned business interest ceases to be located in the United States.

"(2) ADDITIONAL ESTATE TAX.—

"(A) IN GENERAL.—The amount of the additional estate tax imposed by paragraph (1) shall be equal to—

"(i) the applicable percentage of the adjusted tax difference attributable to the qualified family-owned business interest (as determined under rules similar to the rules of section 2032A(c)(2)(B)), plus

"(ii) interest on the amount determined under clause (i) at the underpayment rate established under section 6621 for the period beginning on the date the estate tax liability was due under this chapter and ending on the date such additional estate tax is due.

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined under the following table:

“If the event described in paragraph (1) occurs in the following year of material participation:	*The applicable percentage is:*
1 through 6	*100*
7	*80*
8	*60*
9	*40*
10	*20.*

“(g) SECURITY REQUIREMENTS FOR NONCITIZEN QUALIFIED HEIRS.—

“(1) IN GENERAL.—Except upon the application of subparagraph (F) or (M) of subsection (i)(3), if a qualified heir is not a citizen of the United States, any interest under this section passing to or acquired by such heir (including any interest held by such heir at a time described in subsection (f)(1)(C)) shall be treated as a qualified family-owned business interest only if the interest passes or is acquired (or is held) in a qualified trust.

“(2) QUALIFIED TRUST.—The term ‘qualified trust’ means a trust—

“(A) which is organized under, and governed by, the laws of the United States or a State, and

“(B) except as otherwise provided in regulations, with respect to which the trust instrument requires that at least 1 trustee of the trust be an individual citizen of the United States or a domestic corporation.

“(h) AGREEMENT.—The agreement referred to in this subsection is a written agreement signed by each person in being who has an interest (whether or not in possession) in any property designated in such agreement consenting to the application of subsection (f) with respect to such property.

“(i) OTHER DEFINITIONS AND APPLICABLE RULES.—For purposes of this section—

“(1) QUALIFIED HEIR.—The term ‘qualified heir’—

“(A) has the meaning given to such term by section 2032A(e)(1), and

“(B) includes any active employee of the trade or business to which the qualified family-owned business interest relates if such employee has been employed by such trade or business for a period of at least 10 years before the date of the decedent’s death.

“(2) MEMBER OF THE FAMILY.—The term ‘member of the family’ has the meaning given to such term by section 2032A(e)(2).

“(3) APPLICABLE RULES.—Rules similar to the following rules shall apply:

“(A) Section 2032A(b)(4) (relating to decedents who are retired or disabled).

“(B) Section 2032A(b)(5) (relating to special rules for surviving spouses).

“(C) Section 2032A(c)(2)(D) (relating to partial dispositions).

“(D) Section 2032A(c)(3) (relating to only 1 additional tax imposed with respect to any 1 portion).

“(E) Section 2032A(c)(4) (relating to due date).

“(F) Section 2032A(c)(5) (relating to liability for tax; furnishing of bond).

“(G) Section 2032A(c)(7) (relating to no tax if use begins within 2 years; active management by eligible qualified heir treated as material participation).

“(H) Paragraphs (1) and (3) of section 2032A(d) (relating to election; agreement).

“(I) Section 2032A(e)(10) (relating to community property).

“(J) Section 2032A(e)(14) (relating to treatment of replacement property acquired in section 1031 or 1033 transactions).

“(K) Section 2032A(f) (relating to statute of limitations).

“(L) Section 6166(b)(3) (relating to farmhouses and certain other structures taken into account).

“(M) Subparagraphs (B), (C), and (D) of section 6166(g)(1) (relating to acceleration of payment).

“(N) Section 6324B (relating to special lien for additional estate tax).”.

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter A of chapter 11 is amended by inserting after the item relating to section 2033 the following new item:

“Sec. 2033A. Family-owned business exclusion.”.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 1997.

SEC. 503. MODIFICATIONS TO RATE OF INTEREST ON PORTION OF ESTATE TAX EXTENDED UNDER SECTION 6166.

(a) IN GENERAL.—Paragraphs (1) and (2) of section 6601(j) (relating to 4-percent rate on certain portion of estate tax extended under section 6166) are amended to read as follows:

“(1) IN GENERAL.—If the time for payment of an amount of tax imposed by chapter 11 is extended as provided in section 6166, then in lieu of the annual rate provided by subsection (a)—

“(A) interest on the 2-percent portion of such amount shall be paid at the rate of 2 percent, and

“(B) interest on so much of such amount as exceeds the 2-percent portion shall be paid at a rate equal to 45 percent of the annual rate provided by subsection (a).

For purposes of this subsection, the amount of any deficiency which is prorated to installments payable under section 6166 shall be treated as an amount of tax payable in installments under such section.

“(2) 2-PERCENT PORTION.—For purposes of this subsection, the term ‘2-percent portion’ means the lesser of—

“(A)(i) 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 sum of $1,000,000 and the applicable exclusion amount in effect under section 2010(c), reduced by

"(ii) the applicable credit amount in effect under section 2010(c), or

"(B) the amount of the tax imposed by chapter 11 which is extended as provided in section 6166.".

(b) DISALLOWANCE OF INTEREST DEDUCTION.—

(1) ESTATE TAX.—Paragraph (1) of section 2053(c) is amended by adding at the end the following new subparagraph:

"(D) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.".

(2) INCOME TAX.—

(A) Section 163 is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) SECTION 6166 INTEREST.—No deduction shall be allowed under this section for any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6166.".

(B) Subparagraph (E) of section 163(h)(2) is amended by striking "or 6166" and all that follows and inserting a period.

(c) CONFORMING AMENDMENTS.—

(1) Paragraphs (7)(A)(iii) and (8)(A)(iii) of section 6166(b) are amended by striking "4-percent" each place it appears (including the heading) and inserting "2-percent".

(2) Paragraph (4) of section 6601(j), as redesignated by section 501(e), is amended by striking "4-percent" each place it appears and inserting "2-percent".

(3) The subsection heading for section 6601(j) is amended by striking "4-PERCENT" and inserting "2-PERCENT".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to estates of decedents dying after December 31, 1997.

(2) ELECTION.—In the case of the estate of any decedent dying before January 1, 1998, with respect to which there is an election under section 6166 of the Internal Revenue Code of 1986, the executor of the estate may elect to have the amendments made by this section apply with respect to installments due after the effective date of the election; except that the 2-percent portion of such installments shall be equal to the amount which would be the 4-percent portion of such installments without regard to such election. Such an election shall be made before January 1, 1999 in the manner prescribed by the Secretary of the Treasury and, once made, is irrevocable.

SEC. 504. EXTENSION OF TREATMENT OF CERTAIN RENTS UNDER SECTION 2032A TO LINEAL DESCENDANTS.

(a) GENERAL RULE.—Paragraph (7) of section 2032A(c) (relating to special rules for tax treatment of dispositions and failures to use

for qualified use) is amended by adding at the end the following new subparagraph:

“(E) CERTAIN RENTS TREATED AS QUALIFIED USE.—For purposes of this subsection, a surviving spouse or lineal descendant of the decedent shall not be treated as failing to use qualified real property in a qualified use solely because such spouse or descendant rents such property to a member of the family of such spouse or descendant on a net cash basis. For purposes of the preceding sentence, a legally adopted child of an individual shall be treated as the child of such individual by blood.”.

(b) CONFORMING AMENDMENT.—Section 2032A(b)(5)(A) is amended by striking the last sentence.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to leases entered into after December 31, 1976.

SEC. 505. CLARIFICATION OF JUDICIAL REVIEW OF ELIGIBILITY FOR EXTENSION OF TIME FOR PAYMENT OF ESTATE TAX.

(a) IN GENERAL.—Part IV of subchapter C of chapter 76 of the Internal Revenue Code of 1986 (relating to declaratory judgments) is amended by adding at the end the following new section:

“SEC. 7479. DECLARATORY JUDGMENTS RELATING TO ELIGIBILITY OF ESTATE WITH RESPECT TO INSTALLMENT PAYMENTS UNDER SECTION 6166.

“(a) CREATION OF REMEDY.—In a case of actual controversy involving a determination by the Secretary of (or a failure by the Secretary to make a determination with respect to)—

“(1) whether an election may be made under section 6166 (relating to extension of time for payment of estate tax where estate consists largely of interest in closely held business) with respect to an estate, or

“(2) whether the extension of time for payment of tax provided in section 6166(a) has ceased to apply with respect to an estate,

upon the filing of an appropriate pleading, the Tax Court may make a declaration with respect to whether such election may be made or whether such extension has ceased to apply. Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

“(b) LIMITATIONS.—

“(1) PETITIONER.—A pleading may be filed under this section, with respect to any estate, only—

“(A) by the executor of such estate, or

“(B) by any person who has assumed an obligation to make payments under section 6166 with respect to such estate (but only if each other such person is joined as a party).

“(2) EXHAUSTION OF ADMINISTRATIVE REMEDIES.—The court shall not issue a declaratory judgment or decree under this section in any proceeding unless it determines that the petitioner has exhausted all available administrative remedies within the Internal Revenue Service. A petitioner shall be deemed to have exhausted its administrative remedies with respect to a failure of the Secretary to make a determination at the expiration of

180 days after the date on which the request for such determination was made if the petitioner has taken, in a timely manner, all reasonable steps to secure such determination.

"(3) TIME FOR BRINGING ACTION.—If the Secretary sends by certified or registered mail notice of his determination as described in subsection (a) to the petitioner, no proceeding may be initiated under this section unless the pleading is filed before the 91st day after the date of such mailing.".

(b) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter C of chapter 76 of such Code is amended by adding at the end the following new item:

"Sec. 7479. Declaratory judgments relating to eligibility of estate with respect to installment payments under section 6166.".

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

SEC. 506. GIFTS MAY NOT BE REVALUED FOR ESTATE TAX PURPOSES AFTER EXPIRATION OF STATUTE OF LIMITATIONS.

(a) IN GENERAL.—Section 2001 (relating to imposition and rate of estate tax) is amended by adding at the end the following new subsection:

"(f) VALUATION OF GIFTS.—If—

"(1) the time has expired within which a tax may be assessed under chapter 12 (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period (as defined in section 2502(b)), and

"(2) the value of such gift is shown on the return for such preceding calendar period or is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such gift,

the value of such gift shall, for purposes of computing the tax under this chapter, be the value of such gift as finally determined for purposes of chapter 12.".

(b) MODIFICATION OF APPLICATION OF STATUTE OF LIMITATIONS.—Paragraph (9) of section 6501(c) is amended to read as follows:

"(9) GIFT TAX ON CERTAIN GIFTS NOT SHOWN ON RETURN.—If any gift of property the value of which (or any increase in taxable gifts required under section 2701(d) which) is required to be shown on a return of tax imposed by chapter 12 (without regard to section 2503(b)), and is not shown on such return, any tax imposed by chapter 12 on such gift may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time. The preceding sentence shall not apply to any item which is disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item. The value of any item which is so disclosed may not be redetermined by the Secretary after the expiration of the period under subsection (a).".

(c) DECLARATORY JUDGMENT PROCEDURE FOR DETERMINING VALUE OF GIFT.—

(1) IN GENERAL.—Part IV of subchapter C of chapter 76 is amended by inserting after section 7476 the following new section:

"SEC. 7477. DECLARATORY JUDGMENTS RELATING TO VALUE OF CERTAIN GIFTS.

"(a) CREATION OF REMEDY.—In a case of an actual controversy involving a determination by the Secretary of the value of any gift shown on the return of tax imposed by chapter 12 or disclosed on such return or in any statement attached to such return, upon the filing of an appropriate pleading, the Tax Court may make a declaration of the value of such gift. Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

"(b) LIMITATIONS.—

"(1) PETITIONER.—A pleading may be filed under this section only by the donor.

"(2) EXHAUSTION OF ADMINISTRATIVE REMEDIES.—The court shall not issue a declaratory judgment or decree under this section in any proceeding unless it determines that the petitioner has exhausted all available administrative remedies within the Internal Revenue Service.

"(3) TIME FOR BRINGING ACTION.—If the Secretary sends by certified or registered mail notice of his determination as described in subsection (a) to the petitioner, no proceeding may be initiated under this section unless the pleading is filed before the 91st day after the date of such mailing.".

(2) CLERICAL AMENDMENT.—The table of sections for such part IV is amended by inserting after the item relating to section 7476 the following new item:

"Sec. 7477. Declaratory judgments relating to value of certain gifts.".

(d) CONFORMING AMENDMENT.—Subsection (c) of section 2504 is amended by striking ", and if a tax under this chapter or under corresponding provisions of prior laws has been assessed or paid for such preceding calendar period".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by subsections (a) and (c) shall apply to gifts made after the date of the enactment of this Act.

(2) SUBSECTION (b)—The amendment made by subsection (b) shall apply to gifts made in calendar years ending after the date of the enactment of this Act.

SEC. 507. REPEAL OF THROWBACK RULES APPLICABLE TO CERTAIN DOMESTIC TRUSTS.

(a) ACCUMULATION DISTRIBUTIONS.—

(1) IN GENERAL.—Section 665 is amended by inserting after subsection (b) the following new subsection:

"(c) EXCEPTION FOR ACCUMULATION DISTRIBUTIONS FROM CERTAIN DOMESTIC TRUSTS.—For purposes of this subpart—

"(1) IN GENERAL.—In the case of a qualified trust, any distribution in any taxable year beginning after the date of the enactment of this subsection shall be computed without regard to any undistributed net income.

"(2) QUALIFIED TRUST.—For purposes of this subsection, the term 'qualified trust' means any trust other than—

"(A) a foreign trust (or, except as provided in regulations, a domestic trust which at any time was a foreign trust), or

"(B) a trust created before March 1, 1984, unless it is established that the trust would not be aggregated with other trusts under section 643(f) if such section applied to such trust.".

(2) CONFORMING AMENDMENTS.—Subsection (b) of section 665 is amended by inserting "except as provided in subsection (c)," after "subpart,".

(b) REPEAL OF TAX ON TRANSFERS TO TRUSTS AT LESS THAN FAIR MARKET VALUE.—

(1) Subpart A of part I of subchapter J of chapter 1 is amended by striking section 644 and by redesignating section 645 as section 644.

(2) Paragraph (5) of section 706(b) is amended by striking "section 645" and inserting "section 644".

(3) The table of sections for such subpart is amended by striking the last 2 items and inserting the following new item:

"Sec. 644. Taxable year of trusts."

(c) EFFECTIVE DATES.—

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

(2) TRANSFERRED PROPERTY.—The amendments made by subsection (b) shall apply to sales or exchanges after the date of the enactment of this Act.

SEC. 508. TREATMENT OF LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.

(a) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—Section 2031 (relating to the definition of gross estate) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) ESTATE TAX WITH RESPECT TO LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—

"(1) IN GENERAL.—If the executor makes the election described in paragraph (6), then, except as otherwise provided in this subsection, there shall be excluded from the gross estate the lesser of—

"(A) the applicable percentage of the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or

"(B) the exclusion limitation.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term 'applicable percentage' means 40 percent reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement

and reduced by the value of any retained development right (as defined in paragraph (5)).

“(3) EXCLUSION LIMITATION.—For purposes of paragraph (1), the exclusion limitation is the limitation determined in accordance with the following table:

“In the case of estates of decedents dying during:	***The exclusion limitation is:***
1998	*$100,000*
1999	*$200,000*
2000	*$300,000*
2001	*$400,000*
2002 or thereafter	*$500,000.*

“(4) TREATMENT OF CERTAIN INDEBTEDNESS.—

“(A) IN GENERAL.—The exclusion provided in paragraph (1) shall not apply to the extent that the land is debt-financed property.

“(B) DEFINITIONS.—For purposes of this paragraph—

“(i) DEBT-FINANCED PROPERTY.—The term ‘debt-financed property’ means any property with respect to which there is an acquisition indebtedness (as defined in clause (ii)) on the date of the decedent’s death.

“(ii) ACQUISITION INDEBTEDNESS.—The term ‘acquisition indebtedness’ means, with respect to debt-financed property, the unpaid amount of—

“(I) the indebtedness incurred by the donor in acquiring such property,

“(II) the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition,

“(III) the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition, and

“(IV) the extension, renewal, or refinancing of an acquisition indebtedness.

“(5) TREATMENT OF RETAINED DEVELOPMENT RIGHT.—

“(A) IN GENERAL.—Paragraph (1) shall not apply to the value of any development right retained by the donor in the conveyance of a qualified conservation easement.

“(B) TERMINATION OF RETAINED DEVELOPMENT RIGHT.—If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights (as defined in subparagraph (D)) retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly. Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.

"(C) ADDITIONAL TAX.—Any failure to implement the agreement described in subparagraph (B) not later than the earlier of—

"(i) the date which is 2 years after the date of the decedent's death, or

"(ii) the date of the sale of such land subject to the qualified conservation easement,

shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained development rights subject to such agreement. Such additional tax shall be due and payable on the last day of the 6th month following such date.

"(D) DEVELOPMENT RIGHT DEFINED.—For purposes of this paragraph, the term 'development right' means any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes (within the meaning of section 2032A(e)(5)).

"(6) ELECTION.—The election under this subsection shall be made on the return of the tax imposed by section 2001. Such an election, once made, shall be irrevocable.

"(7) CALCULATION OF ESTATE TAX DUE.—An executor making the election described in paragraph (6) shall, for purposes of calculating the amount of tax imposed by section 2001, include the value of any development right (as defined in paragraph (5)) retained by the donor in the conveyance of such qualified conservation easement. The computation of tax on any retained development right prescribed in this paragraph shall be done in such manner and on such forms as the Secretary shall prescribe.

"(8) DEFINITIONS.—For purposes of this subsection—

"(A) LAND SUBJECT TO A QUALIFIED CONSERVATION EASEMENT.—The term 'land subject to a qualified conservation easement' means land—

"(i) which is located—

"(I) in or within 25 miles of an area which, on the date of the decedent's death, is a metropolitan area (as defined by the Office of Management and Budget),

"(II) in or within 25 miles of an area which, on the date of the decedent's death, is a national park or wilderness area designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within 25 miles of such a park or wilderness area is not under significant development pressure), or

"(III) in or within 10 miles of an area which, on the date of the decedent's death, is an Urban National Forest (as designated by the Forest Service),

"(ii) which was owned by the decedent or a member of the decedent's family at all times during the 3-

year period ending on the date of the decedent's death, and

"(iii) with respect to which a qualified conservation easement has been made by an individual described in subparagraph (C), as of the date of the election described in paragraph (6).

"(B) QUALIFIED CONSERVATION EASEMENT.—The term 'qualified conservation easement' means a qualified conservation contribution (as defined in section 170(h)(1)) of a qualified real property interest (as defined in section 170(h)(2)(C)), except that clause (iv) of section 170(h)(4)(A) shall not apply, and the restriction on the use of such interest described in section 170(h)(2)(C) shall include a prohibition on more than a de minimis use for a commercial recreational activity.

"(C) INDIVIDUAL DESCRIBED.—An individual is described in this subparagraph if such individual is—

"(i) the decedent,

"(ii) a member of the decedent's family,

"(iii) the executor of the decedent's estate, or

"(iv) the trustee of a trust the corpus of which includes the land to be subject to the qualified conservation easement.

"(D) MEMBER OF FAMILY.—The term 'member of the decedent's family' means any member of the family (as defined in section 2032A(e)(2)) of the decedent.

"(9) APPLICATION OF THIS SECTION TO INTERESTS IN PARTNERSHIPS, CORPORATIONS, AND TRUSTS.—This section shall apply to an interest in a partnership, corporation, or trust if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, as determined under the rules described in section 2033A(e)(3).".

(b) CARRYOVER BASIS.—Section 1014(a) (relating to basis of property acquired from a decedent) is amended by striking "or" at the end of paragraphs (1) and (2), by striking the period at the end of paragraph (3) and inserting ", or" and by adding at the end the following new paragraph:

"(4) to the extent of the applicability of the exclusion described in section 2031(c), the basis in the hands of the decedent.".

(c) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—Subsection (c) of section 2032A (relating to alternative valuation method) is amended by adding at the end the following new paragraph:

"(8) QUALIFIED CONSERVATION CONTRIBUTION IS NOT A DISPOSITION.—A qualified conservation contribution (as defined in section 170(h)) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A).".

(d) QUALIFIED CONSERVATION CONTRIBUTION WHERE SURFACE AND MINERAL RIGHTS ARE SEPARATED.—Section 170(h)(5)(B)(ii) (relating to special rule) is amended to read as follows:

"(ii) SPECIAL RULE.—With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph

(A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.".

(e) EFFECTIVE DATES.—

(1) ENCLUSION.—The amendments made by subsections (a) and (b) shall apply to estates of decedents dying after December 31, 1997.

(2) EASEMENTS.—The amendments made by subsections (c) and (d) shall apply to easements granted after December 31, 1997.

Subtitle B—Generation-Skipping Tax Provision

SEC. 511. EXPANSION OF EXCEPTION FROM GENERATION-SKIPPING TRANSFER TAX FOR TRANSFERS TO INDIVIDUALS WITH DECEASED PARENTS.

(a) IN GENERAL.—Section 2651 (relating to generation assignment) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) SPECIAL RULE FOR PERSONS WITH A DECEASED PARENT.—

"(1) IN GENERAL.—For purposes of determining whether any transfer is a generation-skipping transfer, if—

"(A) an individual is a descendant of a parent of the transferor (or the transferor's spouse or former spouse), and

"(B) such individual's parent who is a lineal descendant of the parent of the transferor (or the transferor's spouse or former spouse) is dead at the time the transfer (from which an interest of such individual is established or derived) is subject to a tax imposed by chapter 11 or 12 upon the transferor (and if there shall be more than 1 such time, then at the earliest such time),

such individual shall be treated as if such individual were a member of the generation which is 1 generation below the lower of the transferor's generation or the generation assignment of the youngest living ancestor of such individual who is also a descendant of the parent of the transferor (or the transferor's spouse or former spouse), and the generation assignment of any descendant of such individual shall be adjusted accordingly.

"(2) LIMITED APPLICATION OF SUBSECTION TO COLLATERAL HEIRS.—This subsection shall not apply with respect to a transfer to any individual who is not a lineal descendant of the transferor (or the transferor's spouse or former spouse) if, at the time of the transfer, such transferor has any living lineal descendant.".

(b) CONFORMING AMENDMENTS.—

(1) Section 2612(c) (defining direct skip) is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(2) Section 2612(c)(2) (as so redesignated) is amended by striking "section 2651(e)(2)" and inserting "section 2651(f)(2)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to terminations, distributions, and transfers occurring after December 31, 1997.

TITLE VI—EXTENSIONS

SEC. 601. RESEARCH TAX CREDIT.

(a) IN GENERAL.—Paragraph (1) of section 41(h) (relating to termination) is amended—

(1) by striking "May 31, 1997" and inserting "June 30, 1998", and

(2) by striking in the last sentence "during the first 11 months of such taxable year." and inserting "during the 24-month period beginning with the first month of such year. The 24 months referred to in the preceding sentence shall be reduced by the number of full months after June 1996 (and before the first month of such first taxable year) during which the taxpayer paid or incurred any amount which is taken into account in determining the credit under this section.".

(b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 41(c)(4) is amended to read as follows:

"(B) ELECTION.—An election under this paragraph shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Secretary.".

(2) Paragraph (1) of section 45C(b) is amended by striking "May 31, 1997" and inserting "June 30, 1998".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after May 31, 1997.

SEC. 602. CONTRIBUTIONS OF STOCK TO PRIVATE FOUNDATIONS.

(a) IN GENERAL.—Clause (ii) of section 170(e)(5)(D) (relating to termination) is amended by striking "May 31, 1997" and inserting "June 30, 1998".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to contributions made after May 31, 1997.

SEC. 603. WORK OPPORTUNITY TAX CREDIT.

(a) EXTENSION.—Subparagraph (B) of section 51(c)(4) (relating to termination) is amended by striking "September 30, 1997" and inserting "June 30, 1998".

(b) MODIFICATION OF ELIGIBILITY REQUIREMENT BASED ON PERIOD ON WELFARE.—

(1) IN GENERAL.—Subparagraph (A) of section 51(d)(2) (defining qualified IV–A recipient) is amended by striking all that follows "a IV–A program" and inserting "for any 9 months during the 18-month period ending on the hiring date.".

(2) CONFORMING AMENDMENT.—Subparagraph (A) of section 51(d)(3) is amended to read as follows:

"(A) IN GENERAL.—The term 'qualified veteran' means any veteran who is certified by the designated local agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for at least a 3-month period ending during the 12-month period ending on the hiring date.".

(c) QUALIFIED SSI RECIPIENTS TREATED AS MEMBERS OF TARGETED GROUPS.—

(1) IN GENERAL.—Section 51(d)(1) (relating to members of targeted groups) is amended by striking "or" at the end of subparagraph (F), by striking the period at the end of subparagraph (G) and inserting ", or", and by adding at the end the following new subparagraph:

"(H) a qualified SSI recipient.".

(2) QUALIFIED SSI RECIPIENTS.—Section 51(d) is amended by redesignating paragraphs (9), (10), and (11) as paragraphs (10), (11), and (12), respectively, and by inserting after paragraph (8) the following new paragraph:

"(9) QUALIFIED SSI RECIPIENT.—The term 'qualified SSI recipient' means any individual who is certified by the designated local agency as receiving supplemental security income benefits under title XVI of the Social Security Act (including supplemental security income benefits of the type described in section 1616 of such Act or section 212 of Public Law 93–66) for any month ending within the 60-day period ending on the hiring date.".

(d) PERCENTAGE OF WAGES ALLOWED AS CREDIT.—

(1) IN GENERAL.—Subsection (a) of section 51 (relating to determination of amount) is amended by striking "35 percent" and inserting "40 percent".

(2) APPLICATION OF CREDIT FOR INDIVIDUALS PERFORMING FEWER THAN 400 HOURS OF SERVICES.—Paragraph (3) of section 51(i) is amended to read as follows:

"(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIODS.—

"(A) REDUCTION OF CREDIT FOR INDIVIDUALS PERFORMING FEWER THAN 400 HOURS OF SERVICE.—In the case of an individual who has performed at least 120 hours, but less than 400 hours, of service for the employer, subsection (a) shall be applied by substituting '25 percent' for '40 percent'.

"(B) DENIAL OF CREDIT FOR INDIVIDUALS PERFORMING FEWER THAN 120 HOURS OF SERVICE.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual has performed at least 120 hours of service for the employer.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals who begin work for the employer after September 30, 1997.

SEC. 604. ORPHAN DRUG TAX CREDIT.

(a) IN GENERAL.—Section 45C (relating to clinical testing expenses for certain drugs for rare diseases or conditions) is amended by striking subsection (e).

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid or incurred after May 31, 1997.

TITLE VII—INCENTIVES FOR REVITALIZATION OF THE DISTRICT OF COLUMBIA

SEC. 701. TAX INCENTIVES FOR REVITALIZATION OF THE DISTRICT OF COLUMBIA.

(a) IN GENERAL.—Chapter 1 is amended by adding at the end the following new subchapter:

"Subchapter W—District of Columbia Enterprise Zone

"SEC. 1400. ESTABLISHMENT OF DC ZONE.

"(a) IN GENERAL.—For purposes of this title—

"(1) the applicable DC area is hereby designated as the District of Columbia Enterprise Zone, and

"(2) except as otherwise provided in this subchapter, the District of Columbia Enterprise Zone shall be treated as an empowerment zone designated under subchapter U.

"(b) APPLICABLE DC AREA.—For purposes of subsection (a), the term 'applicable DC area' means the area consisting of—

"(1) the census tracts located in the District of Columbia which are part of an enterprise community designated under subchapter U before the date of the enactment of this subchapter, and

"(2) all other census tracts—

"(A) which are located in the District of Columbia, and

"(B) for which the poverty rate is not less than than 20 percent.

"(c) DISTRICT OF COLUMBIA ENTERPRISE ZONE.—For purposes of this subchapter, the terms 'District of Columbia Enterprise Zone' and 'DC Zone' mean the District of Columbia Enterprise Zone designated by subsection (a).

"(d) SPECIAL RULES FOR APPLICATION OF EMPLOYMENT CREDIT.—

"(1) EMPLOYEES WHOSE PRINCIPAL PLACE OF ABODE IS IN DISTRICT OF COLUMBIA.—With respect to the DC Zone, section 1396(d)(1)(B) (relating to empowerment zone employment credit) shall be applied by substituting 'the District of Columbia' for 'such empowerment zone'.

"(2) NO DECREASE OF PERCENTAGE IN 2002.—In the case of the DC Zone, section 1396 (relating to empowerment zone employment credit) shall be applied by substituting "20" for "15" in the table contained in section 1396(b). The preceding sentence shall apply only with respect to qualified zone employees, as defined in section 1396(d), determined by treating no area other than the DC Zone as an empowerment zone or enterprise community.

"(e) SPECIAL RULE FOR APPLICATION OF ENTERPRISE ZONE BUSINESS DEFINITION.—For purposes of this subchapter and for purposes of applying subchapter U with respect to the DC Zone, sec-

tion 1397B shall be applied without regard to subsections (b)(6) and (c)(5) thereof.

"(f) TIME FOR WHICH DESIGNATION APPLICABLE.—

"(1) IN GENERAL.—The designation made by subsection (a) shall apply for the period beginning on January 1, 1998, and ending on December 31, 2002.

"(2) COORDINATION WITH DC ENTERPRISE COMMUNITY DESIGNATED UNDER SUBCHAPTER U.—The designation under subchapter U of the census tracts referred to in subsection (b)(1) as an enterprise community shall terminate on December 31, 2002.

"SEC. 1400A. TAX-EXEMPT ECONOMIC DEVELOPMENT BONDS.

"(a) IN GENERAL.—In the case of the District of Columbia Enterprise Zone, subparagraph (A) of section 1394(c)(1) (relating to limitation on amount of bonds) shall be applied by substituting '$15,000,000' for '$3,000,000'.

"(b) PERIOD OF APPLICABILITY.—This section shall apply to bonds issued during the period beginning on January 1, 1998, and ending on December 31, 2002.

"SEC. 1400B. ZERO PERCENT CAPITAL GAINS RATE.

"(a) EXCLUSION.—Gross income shall not include qualified capital gain from the sale or exchange of any DC Zone asset held for more than 5 years.

"(b) DC ZONE ASSET.—For purposes of this section—

"(1) IN GENERAL.—The term 'DC Zone asset' means—

"(A) any DC Zone business stock,

"(B) any DC Zone partnership interest, and

"(C) any DC Zone business property.

"(2) DC ZONE BUSINESS STOCK.—

"(A) IN GENERAL.—The term 'DC Zone business stock' means any stock in a domestic corporation which is originally issued after December 31, 1997, if—

"(i) such stock is acquired by the taxpayer, before January 1, 2003, at its original issue (directly or through an underwriter) solely in exchange for cash,

"(ii) as of the time such stock was issued, such corporation was a DC Zone business (or, in the case of a new corporation, such corporation was being organized for purposes of being a DC Zone business), and

"(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a DC Zone business.

"(B) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

"(3) DC ZONE PARTNERSHIP INTEREST.—The term 'DC Zone partnership interest' means any capital or profits interest in a domestic partnership which is originally issued after December 31, 1997, if—

"(A) such interest is acquired by the taxpayer, before January 1, 2003, from the partnership solely in exchange for cash,

"(B) as of the time such interest was acquired, such partnership was a DC Zone business (or, in the case of a

new partnership, such partnership was being organized for purposes of being a DC Zone business), and

“(C) during substantially all of the taxpayer’s holding period for such interest, such partnership qualified as a DC Zone business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

“(4) DC ZONE BUSINESS PROPERTY.—

“(A) IN GENERAL.—The term ‘DC Zone business property’ means tangible property if—

“(i) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 1997, and before January 1, 2003,

“(ii) the original use of such property in the DC Zone commences with the taxpayer, and

“(iii) during substantially all of the taxpayer’s holding period for such property, substantially all of the use of such property was in a DC Zone business of the taxpayer.

“(B) SPECIAL RULE FOR BUILDINGS WHICH ARE SUBSTANTIALLY IMPROVED.—

“(i) IN GENERAL.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as met with respect to—

“(I) property which is substantially improved by the taxpayer before January 1, 2003, and

“(II) any land on which such property is located.

“(ii) SUBSTANTIAL IMPROVEMENT.—For purposes of clause (i), property shall be treated as substantially improved by the taxpayer only if, during any 24-month period beginning after December 31, 1997, additions to basis with respect to such property in the hands of the taxpayer exceed the greater of—

“(I) an amount equal to the adjusted basis of such property at the beginning of such 24-month period in the hands of the taxpayer, or

“(II) $5,000.

“(6) TREATMENT OF SUBSEQUENT PURCHASERS, ETC.—The term ‘DC Zone asset’ includes any property which would be a DC Zone asset but for paragraph (2)(A)(i), (3)(A), or (4)(A)(ii) in the hands of the taxpayer if such property was a DC Zone asset in the hands of a prior holder.

“(7) 5-YEAR SAFE HARBOR.—If any property ceases to be a DC Zone asset by reason of paragraph (2)(A)(iii), (3)(C), or (4)(A)(iii) after the 5-year period beginning on the date the taxpayer acquired such property, such property shall continue to be treated as meeting the requirements of such paragraph; except that the amount of gain to which subsection (a) applies on any sale or exchange of such property shall not exceed the amount which would be qualified capital gain had such property been sold on the date of such cessation.

"(c) DC ZONE BUSINESS.—For purposes of this section, the term 'DC Zone business' means any entity which is an enterprise zone business (as defined in section 1397B), determined—

"(1) after the application of section 1400(e),

"(2) by substituting "80 percent" for "50 percent" in subsections (b)(2) and (c)(1) of section 1397B, and

"(3) by treating no area other than the DC Zone as an empowerment zone or enterprise community.

"(d) TREATMENT OF ZONE AS INCLUDING CENSUS TRACTS WITH 10 PERCENT POVERTY RATE.—For purposes of applying this section (and for purposes of applying this subchapter and subchapter U with respect to this section), the DC Zone shall be treated as including all census tracts—

"(1) which are located in the District of Columbia, and

"(2) for which the poverty rate is not less than 10 percent.

"(e) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) QUALIFIED CAPITAL GAIN.—Except as otherwise provided in this subsection, the term 'qualified capital gain' means any gain recognized on the sale or exchange of—

"(A) a capital asset, or

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

"(2) GAIN BEFORE 1998 OR AFTER 2007 NOT QUALIFIED.—The term 'qualified capital gain' shall not include any gain attributable to periods before January 1, 1998, or after December 31, 2007.

"(3) CERTAIN GAIN NOT QUALIFIED.—The term 'qualified capital gain' shall not include any gain which would be treated as ordinary income under section 1245 or under section 1250 if section 1250 applied to all depreciation rather than the additional depreciation.

"(4) INTANGIBLES AND LAND NOT INTEGRAL PART OF DC ZONE BUSINESS.—The term 'qualified capital gain' shall not include any gain which is attributable to real property, or an intangible asset, which is not an integral part of a DC Zone business.

"(5) RELATED PARTY TRANSACTIONS.—The term 'qualified capital gain' shall not include any gain attributable, directly or indirectly, in whole or in part, to a transaction with a related person. For purposes of this paragraph, persons are related to each other if such persons are described in section 267(b) or 707(b)(1).

"(f) CERTAIN OTHER RULES TO APPLY.—Rules similar to the rules of subsections (g), (h), (i)(2), and (j) of section 1202 shall apply for purposes of this section.

"(g) SALES AND EXCHANGES OF INTERESTS IN PARTNERSHIPS AND S CORPORATIONS WHICH ARE DC ZONE BUSINESSES.—In the case of the sale or exchange of an interest in a partnership, or of stock in an S corporation, which was a DC Zone business during substantially all of the period the taxpayer held such interest or stock, the amount of qualified capital gain shall be determined without regard to—

"(1) any gain which is attributable to real property, or an intangible asset, which is not an integral part of a DC Zone business, and

"(2) any gain attributable to periods before January 1, 1998, or after December 31, 2007.

"SEC. 1400C. FIRST-TIME HOMEBUYER CREDIT FOR DISTRICT OF COLUMBIA.

"(a) ALLOWANCE OF CREDIT.—In the case of an individual who is a first-time homebuyer of a principal residence in the District of Columbia during any taxable year, there shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to so much of the purchase price of the residence as does not exceed $5,000.

"(b) LIMITATION BASED ON MODIFIED ADJUSTED GROSS INCOME.—

"(1) IN GENERAL.—The amount allowable as a credit under subsection (a) (determined without regard to this subsection) for the taxable year shall be reduced (but not below zero) by the amount which bears the same ratio to the credit so allowable as—

"(A) the excess (if any) of—

"(i) the taxpayer's modified adjusted gross income for such taxable year, over

"(ii) $70,000 ($110,000 in the case of a joint return), bears to

"(B) $20,000.

"(2) MODIFIED ADJUSTED GROSS INCOME.—For purposes of paragraph (1), the term 'modified adjusted gross income' means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.

"(c) FIRST-TIME HOMEBUYER.—For purposes of this section—

"(1) IN GENERAL.—The term 'first-time homebuyer' has the same meaning as when used in section 72(t)(8)(D)(i), except that 'principal residence in the District of Columbia during the 1-year period' shall be substituted for 'principal residence during the 2-year period' in subclause (I) thereof.

"(2) ONE-TIME ONLY.—If an individual is treated as a first-time homebuyer with respect to any principal residence, such individual may not be treated as a first-time homebuyer with respect to any other principal residence.

"(3) PRINCIPAL RESIDENCE.—The term 'principal residence' has the same meaning as when used in section 121.

"(d) CARRYOVER OF CREDIT.—If the credit allowable under subsection (a) exceeds the limitation imposed by section 26(a) for such taxable year reduced by the sum of the credits allowable under subpart A of part IV of subchapter A (other than this section), such excess shall be carried to the succeeding taxable year and added to the credit allowable under subsection (a) for such taxable year.

"(e) SPECIAL RULES.—For purposes of this section—

"(1) ALLOCATION OF DOLLAR LIMITATION.—

"(A) MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return, sub-

section (a) shall be applied by substituting '$2,500' for '$5,000'.

"(B) OTHER TAXPAYERS.—If 2 or more individuals who are not married purchase a principal residence, the amount of the credit allowed under subsection (a) shall be allocated among such individuals in such manner as the Secretary may prescribe, except that the total amount of the credits allowed to all such individuals shall not exceed $5,000.

"(2) PURCHASE.—

"(A) IN GENERAL.—The term 'purchase' means any acquisition, but only if—

"(i) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267 (b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), and

"(ii) the basis of the property in the hands of the person acquiring it is not determined—

"(I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

"(II) under section 1014(a) (relating to property acquired from a decedent).

"(B) CONSTRUCTION.—A residence which is constructed by the taxpayer shall be treated as purchased by the taxpayer.

"(3) PURCHASE PRICE.—The term 'purchase price' means the adjusted basis of the principal residence on the date of acquisition (within the meaning of section 72(t)(8)(D)(iii)).

"(f) REPORTING.—If the Secretary requires information reporting under section 6045 by a person described in subsection (e)(2) thereof to verify the eligibility of taxpayers for the credit allowable by this section, the exception provided by section 6045(e)(5) shall not apply.

"(g) CREDIT TREATED AS NONREFUNDABLE PERSONAL CREDIT.—For purposes of this title, the credit allowed by this section shall be treated as a credit allowable under subpart A of part IV of subchapter A of this chapter.

"(h) BASIS ADJUSTMENT.—For purposes of this subtitle, if a credit is allowed under this section with respect to the purchase of any residence, the basis of such residence shall be reduced by the amount of the credit so allowed.

"(i) TERMINATION.—This section shall not apply to any property purchased after December 31, 2000."

(b) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 39 is amended by adding at the end the following new paragraph:

"(8) NO CARRYBACK OF DC ZONE CREDITS BEFORE EFFECTIVE DATE.—No portion of the unused business credit for any taxable year which is attributable to the credits allowable under subchapter U by reason of section 1400 may be carried back to a

taxable year ending before the date of the enactment of section 1400.”

(2) Subsection (a) of section 1016 is amended by striking “and” at the end of paragraph (25), by striking the period at the end of paragraph (26) and inserting “, and”, and by adding at the end thereof the following new paragraph:

“(27) in the case of a residence with respect to which a credit was allowed under section 1400C, to the extent provided in section 1400C(h).”

(c) CLERICAL AMENDMENT.—The table of subchapters for chapter 1 is amended by adding at the end the following new item:

“Subchapter W. District of Columbia Enterprise Zone.”.

(d) EFFECTIVE DATE.—Except as provided in subsection (c), the amendments made by this section shall take effect on the date of the enactment of this Act.

TITLE VIII—WELFARE-TO-WORK INCENTIVES

SEC. 801. INCENTIVES FOR EMPLOYING LONG-TERM FAMILY ASSISTANCE RECIPIENTS.

(a) IN GENERAL.—Subpart F of part IV of subchapter A of chapter 1 is amended by inserting after section 51 the following new section:

“SEC. 51A. TEMPORARY INCENTIVES FOR EMPLOYING LONG-TERM FAMILY ASSISTANCE RECIPIENTS.

“(a) DETERMINATION OF AMOUNT.—For purposes of section 38, the amount of the welfare-to-work credit determined under this section for the taxable year shall be equal to—

“(1) 35 percent of the qualified first-year wages for such year, and

“(2) 50 percent of the qualified second-year wages for such year.

“(b) QUALIFIED WAGES DEFINED.—For purposes of this section—

“(1) IN GENERAL.—The term ‘qualified wages’ means the wages paid or incurred by the employer during the taxable year to individuals who are long-term family assistance recipients.

“(2) QUALIFIED FIRST-YEAR WAGES.—The term ‘qualified first-year wages’ means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning with the day the individual begins work for the employer.

“(3) QUALIFIED SECOND-YEAR WAGES.—The term ‘qualified second-year wages’ means, with respect to any individual, qualified wages attributable to service rendered during the 1-year period beginning on the day after the last day of the 1-year period with respect to such individual determined under paragraph (2).

“(4) ONLY FIRST $10,000 OF WAGES PER YEAR TAKEN INTO ACCOUNT.—The amount of the qualified first-year wages, and the amount of qualified second-year wages, which may be taken

into account with respect to any individual shall not exceed $10,000 per year.

“(5) WAGES.—

“(A) IN GENERAL.—The term ‘wages’ has the meaning given such term by section 51(c), without regard to paragraph (4) thereof.

“(B) CERTAIN AMOUNTS TREATED AS WAGES.—The term ‘wages’ includes amounts paid or incurred by the employer which are excludable from such recipient’s gross income under—

“(i) section 105 (relating to amounts received under accident and health plans),

“(ii) section 106 (relating to contributions by employer to accident and health plans),

“(iii) section 127 (relating to educational assistance programs) or would be so excludable but for section 127(d), but only to the extent paid or incurred to a person not related to the employer, or

“(iv) section 129 (relating to dependent care assistance programs).

The amount treated as wages by clause (i) or (ii) for any period shall be based on the reasonable cost of coverage for the period, but shall not exceed the applicable premium for the period under section 4980B(f)(4).

“(C) SPECIAL RULES FOR AGRICULTURAL AND RAILWAY LABOR.—If such recipient is an employee to whom subparagraph (A) or (B) of section 51(h)(1) applies, rules similar to the rules of such subparagraphs shall apply except that—

“(i) such subparagraph (A) shall be applied by substituting ‘$10,000’ for ‘$6,000’, and

“(ii) such subparagraph (B) shall be applied by substituting ‘$833.33’ for ‘$500’.

“(c) LONG-TERM FAMILY ASSISTANCE RECIPIENTS.—For purposes of this section—

“(1) IN GENERAL.—The term ‘long-term family assistance recipient’ means any individual who is certified by the designated local agency (as defined in section 51(d)(10))—

“(A) as being a member of a family receiving assistance under a IV–A program (as defined in section 51(d)(2)(B)) for at least the 18-month period ending on the hiring date,

“(B)(i) as being a member of a family receiving such assistance for 18 months beginning after the date of the enactment of this section, and

“(ii) as having a hiring date which is not more than 2 years after the end of the earliest such 18-month period, or

“(C)(i) as being a member of a family which ceased to be eligible after the date of the enactment of this section for such assistance by reason of any limitation imposed by Federal or State law on the maximum period such assistance is payable to a family, and

“(ii) as having a hiring date which is not more than 2 years after the date of such cessation.

“(2) HIRING DATE.—The term ‘hiring date’ has the meaning given such term by section 51(d).

"(d) *CERTAIN RULES TO APPLY.*—

"(1) *IN GENERAL.*—*Rules similar to the rules of section 52, and subsections (d)(11), (f), (g), (i) (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997), (j), and (k) of section 51, shall apply for purposes of this section.*

"(2) *CREDIT TO BE PART OF GENERAL BUSINESS CREDIT, ETC.*—*References to section 51 in section 38(b), 280C(a), and 1396(c)(3) shall be treated as including references to this section.*

"(e) *COORDINATION WITH WORK OPPORTUNITY CREDIT.*—*If a credit is allowed under this section to an employer with respect to an individual for any taxable year, then for purposes of applying section 51 to such employer, such individual shall not be treated as a member of a targeted group for such taxable year.*

"(f) *TERMINATION.*—*This section shall not apply to individuals who begin work for the employer after April 30, 1999.".*

(b) CLERICAL AMENDMENT.—*The table of sections for subpart F of part IV of subchapter A of chapter 1 is amended by inserting after the item relating to section 51 the following new item:*

"Sec. 51A. Temporary incentives for employing long-term family assistance recipients.".

(c) EFFECTIVE DATE.—*The amendments made by this section shall apply to individuals who begin work for the employer after December 31, 1997.*

TITLE IX—MISCELLANEOUS PROVISIONS

Subtitle A—Provisions Relating to Excise Taxes

SEC. 901. GENERAL REVENUE PORTION OF HIGHWAY MOTOR FUELS TAXES DEPOSITED INTO HIGHWAY TRUST FUND.

(a) IN GENERAL.—*Paragraph (4) of section 9503(b) (relating to certain additional taxes not transferred to Highway Trust Fund) is amended to read as follows:*

"(4) *CERTAIN TAXES NOT TRANSFERRED TO HIGHWAY TRUST FUND.*—*For purposes of paragraphs (1) and (2), there shall not be taken into account the taxes imposed by*—

"(A) *section 4041(d),*

"(B) *section 4081 to the extent attributable to the rate specified in section 4081(a)(2)(B),*

"(C) *section 4041 or 4081 to the extent attributable to fuel used in a train,*

"(D) *in the case of fuels used as described in paragraph (4)(D), (5)(B), or (6)(D) of subsection (c), section 4041 or 4081*—

"(i) *with respect to so much of the rate of tax on gasoline or special motor fuels as exceeds 11.5 cents per gallon, and*

"(ii) *with respect to so much of the rate of tax on diesel fuel or kerosene as exceeds 17.5 cents per gallon,* *"(E) in the case of fuels described in section 4041(b)(2)(A), 4041(k), or 4081(c), section 4041 or 4081 before October 1, 1999, with respect to a rate equal to 2.5 cents per gallon, or*

"(F) in the case of fuels described in section 4081(c)(2), such section before October 1, 1999, with respect to a rate equal to 2.8 cents per gallon.".

(b) MASS TRANSIT PORTION.—Section 9503(e)(2) (relating to transfers to Mass Transit Account) is amended by striking "2 cents" and inserting "2.85 cents".

(c) LIMITATION ON EXPENDITURES.—Subsection (c) of section 9503 is amended by adding at the end the following new paragraph:

"(7) LIMITATION ON EXPENDITURES.—Notwithstanding any other provision of law, in calculating amounts under section 157(a) of title 23, United States Code, and sections 1013(c), 1015(a), and 1015(b) of the Intermodal Surface Transportation Efficiency Act of 1991 (Public Law 102–240; 105 Stat. 1914), deposits in the Highway Trust Fund resulting from the amendments made by the Taxpayer Relief Act of 1997 shall not be taken into account.".

(d) TECHNICAL AMENDMENTS.—

(1) Section 9503 is amended by striking subsection (f).

(2) The last sentence of subparagraph (A) of section 9503(c)(2) is amended by striking "by taking into account only the Highway Trust Fund financing rate applicable to any fuel" and inserting "by taking into account only the portion of the taxes which are deposited into the Highway Trust Fund".

(3) Paragraphs (4)(D), (5)(B), and (6)(D) of section 9503(c) are each amended by striking "attributable to the Highway Trust Fund financing rate" and inserting "deposited into the Highway Trust Fund".

(e) DELAYED DEPOSITS OF HIGHWAY MOTOR FUEL TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986, in the case of deposits of taxes imposed by sections 4041 and 4081 (other than subsection (a)(2)(A)(ii)) of the Internal Revenue Code of 1986, the due date for any deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxes received in the Treasury after September 30, 1997.

SEC. 902. REPEAL OF TAX ON DIESEL FUEL USED IN RECREATIONAL BOATS.

(a) IN GENERAL.—Subparagraph (B) of section 6421(e)(2) (defining off-highway business use) is amended by striking clauses (iii) and (iv).

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (A) of section 4041(a)(1) is amended—

(A) by striking ", a diesel-powered train, or a diesel-powered boat" each place it appears and inserting "or a diesel-powered train", and

(B) by striking "vehicle, train, or boat" and inserting "vehicle or train".

(2) Paragraph (1) of section 4041(a) is amended by striking subparagraph (D).

(3) Paragraph (3) of section 4083(a) is amended by striking ", a diesel-powered train, or a diesel-powered boat" and inserting "or a diesel-powered train".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1998.

SEC. 903. CONTINUED APPLICATION OF TAX ON IMPORTED RECYCLED HALON-1211.

(a) IN GENERAL.—Paragraph (1) of section 4682(d) is amended by striking "recycled halon" and inserting "recycled Halon-1301 or recycled Halon-2402".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 904. UNIFORM RATE OF TAX ON VACCINES.

(a) IN GENERAL.—Subsection (b) of section 4131 is amended to read as follows:

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) shall be 75 cents per dose of any taxable vaccine.

"(2) COMBINATIONS OF VACCINES.—If any taxable vaccine is described in more than 1 subparagraph of section 4132(a)(1), the amount of the tax imposed by subsection (a) on such vaccine shall be the sum of the amounts for the vaccines which are so included.".

(b) TAXABLE VACCINES.—Paragraph (1) of section 4132(a) is amended to read as follows:

"(1) TAXABLE VACCINE.—The term 'taxable vaccine' means any of the following vaccines which are manufactured or produced in the United States or entered into the United States for consumption, use, or warehousing:

"(A) Any vaccine containing diphtheria toxoid.

"(B) Any vaccine containing tetanus toxoid.

"(C) Any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens.

"(D) Any vaccine against measles.

"(E) Any vaccine against mumps.

"(F) Any vaccine against rubella.

"(G) Any vaccine containing polio virus.

"(H) Any HIB vaccine.

"(I) Any vaccine against hepatitis B.

"(J) Any vaccine against chicken pox.".

(c) CONFORMING AMENDMENT.—Subsection (a) of section 4132 is amended by striking paragraphs (2), (3), (4), and (5) and by redesignating paragraphs (6) through (8) as paragraphs (2) through (4), respectively.

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the day after the date of the enactment of this Act.

(e) LIMITATION ON CERTAIN CREDITS OR REFUNDS.—For purposes of applying section 4132(b) of the Internal Revenue Code of 1986 with respect to any claim for credit or refund filed before Jan-

uary 1, 1999, the amount of tax taken into account shall not exceed the tax computed under the rate in effect on the day after the date of the enactment of this Act.

SEC. 905. OPERATORS OF MULTIPLE GASOLINE RETAIL OUTLETS TREATED AS WHOLESALE DISTRIBUTOR FOR REFUND PURPOSES.

(a) IN GENERAL.—Subparagraph (B) of section 6416(a)(4) (defining wholesale distributor) is amended by adding at the end the following new sentence: "Such term includes any person who makes retail sales of gasoline at 10 or more retail motor fuel outlets.".

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

SEC. 906. EXEMPTION OF ELECTRIC AND OTHER CLEAN-FUEL MOTOR VEHICLES FROM LUXURY AUTOMOBILE CLASSIFICATION.

(a) IN GENERAL.—Subsection (a) of section 4001 (relating to imposition of tax) is amended to read as follows:

"(a) IMPOSITION OF TAX.—

"(1) IN GENERAL.—There is hereby imposed on the 1st retail sale of any passenger vehicle a tax equal to 10 percent of the price for which so sold to the extent such price exceeds the applicable amount.

"(2) APPLICABLE AMOUNT.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), the applicable amount is $30,000.

"(B) QUALIFIED CLEAN-FUEL VEHICLE PROPERTY.—In the case of a passenger vehicle which is propelled by a fuel which is not a clean-burning fuel and to which is installed qualified clean-fuel vehicle property (as defined in section 179A(c)(1)(A)) for purposes of permitting such vehicle to be propelled by a clean-burning fuel, the applicable amount is equal to the sum of—

"(i) the dollar amount in effect under subparagraph (A), plus

"(ii) the increase in the price for which the passenger vehicle was sold (within the meaning of section 4002) due to the installation of such property.

"(C) PURPOSE BUILT PASSENGER VEHICLE.—

"(i) IN GENERAL.—In the case of a purpose built passenger vehicle, the applicable amount is equal to 150 percent of the dollar amount in effect under subparagraph (A).

"(ii) PURPOSE BUILT PASSENGER VEHICLE.—For purposes of clause (i), the term 'purpose built passenger vehicle' means a passenger vehicle produced by an original equipment manufacturer and designed so that the vehicle may be propelled primarily by electricity.".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (e) of section 4001 (relating to inflation adjustment) is amended by striking "and section 4003(a)".

(2) Subsection (f) of section 4001 (relating to phasedown) is amended by striking "subsection (a)" and inserting "subsection (a)(1)".

(3) Subparagraph (A) of section 4003(a)(1) is amended by inserting "(other than property described in section 4001(a)(2)(B))" after "part or accessory".

(4) Subparagraph (B) of section 4003(a)(2) is amended to read as follows:

"(B) the appropriate applicable amount as determined under section 4001(a)(2).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales and installations occurring after the date of the enactment of this Act.

SEC. 907. RATE OF TAX ON CERTAIN SPECIAL FUELS DETERMINED ON BASIS OF BTU EQUIVALENCY WITH GASOLINE.

(a) SPECIAL MOTOR FUELS.—

(1) IN GENERAL.—Paragraph (2) of section 4041(a) (relating to special motor fuels) is amended to read as follows:

"(2) SPECIAL MOTOR FUELS.—

"(A) IN GENERAL.—There is hereby imposed a tax on any liquid (other than kerosene, gas oil, fuel oil, or any product taxable under section 4081)—

"(i) sold by any person to an owner, lessee, or other operator of a motor vehicle or motorboat for use as a fuel in such motor vehicle or motorboat, or

"(ii) used by any person as a fuel in a motor vehicle or motorboat unless there was a taxable sale of such liquid under clause (i).

"(B) RATE OF TAX.—The rate of the tax imposed by this paragraph shall be—

"(i) except as otherwise provided in this subparagraph, the rate of tax specified in section 4081(a)(2)(A)(i) which is in effect at the time of such sale or use,

"(ii) 13.6 cents per gallon in the case of liquefied petroleum gas, and

"(iii) 11.9 cents per gallon in the case of liquefied natural gas.

In the case of any sale or use after September 30, 1999, clause (ii) shall be applied by substituting '3.2 cents' for '13.6 cents', and clause (iii) shall be applied by substituting '2.8 cents' for '11.9 cents'.".

(2) CONFORMING AMENDMENT.—Paragraph (1) of section 4041(d) is amended by inserting "and other than liquefied natural gas" after "liquefied petroleum gas".

(b) METHANOL FUEL PRODUCED FROM NATURAL GAS.—Subparagraph (A) of section 4041(m)(1) is amended to read as follows:

"(A) the rate of the tax imposed by subsection (a)(2) shall be—

"(i) after September 30, 1997, and before October 1, 1999—

"(I) in the case of fuel none of the alcohol in which consists of ethanol, 9.15 cents per gallon, and

"(II) in any other case, 11.3 cents per gallon, and

"(ii) after September 30, 1999—

"(I) in the case of fuel none of the alcohol in which consists of ethanol, 2.15 cents per gallon, and

"(II) in any other case, 4.3 cents per gallon, and".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on October 1, 1997.

SEC. 908. MODIFICATION OF TAX TREATMENT OF HARD CIDER.

(a) HARD CIDER CONTAINING LESS THAN 7 PERCENT ALCOHOL TAXED AS WINE.—Subsection (b) of section 5041 (relating to imposition and rate of tax) is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting "; and", and by adding at the end the following new paragraph:

"(6) On hard cider derived primarily from apples or apple concentrate and water, containing no other fruit product, and containing at least one-half of 1 percent and less than 7 percent alcohol by volume, 22.6 cents per wine gallon.".

(b) APPLICATION OF SMALL PRODUCER CREDIT.—Paragraph (1) of section 5041(c) (relating to credit for small domestic producers) is amended by adding at the end the following new sentence: "In the case of wine described in subsection (b)(6), the preceding sentence shall be applied by substituting '5.6 cents' for '90 cents'."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on October 1, 1997.

SEC. 909. STUDY OF FEASIBILITY OF MOVING COLLECTION POINT FOR DISTILLED SPIRITS EXCISE TAX.

(a) IN GENERAL.—The Secretary of the Treasury or his delegate shall conduct a study of options for changing the event on which the tax imposed by section 5001 of the Internal Revenue Code of 1986 is determined. One such option which shall be studied is determining such tax on removal from registered wholesale warehouses. In studying each such option, such Secretary shall focus on administrative issues including—

(1) tax compliance,

(2) the number of taxpayers required to pay the tax,

(3) the types of financial responsibility requirements that might be required, and

(4) special requirements regarding segregation of non-tax-paid distilled spirits from other products.

Such study shall review the effects of each such option on the Department of the Treasury (including staffing and other demands on budgetary resources) and the change in the period between the time such tax is currently paid and the time such tax would be paid under each such option.

(b) REPORT.—The report of such study shall be submitted to the Committee on Finance of the Senate and the Committee on Ways and Means of the House of Representatives not later than March 31, 1998.

SEC. 910. CLARIFICATION OF AUTHORITY TO USE SEMI-GENERIC DESIGNATIONS ON WINE LABELS.

(a) IN GENERAL.—Section 5388 (relating to designation of wines) is amended by adding at the end the following new subsection:

"(c) USE OF SEMI-GENERIC DESIGNATIONS.—

"(1) IN GENERAL.—Semi-generic designations may be used to designate wines of an origin other than that indicated by such name only if—

"(A) there appears in direct conjunction therewith an appropriate appellation of origin disclosing the true place of origin of the wine, and

"(B) the wine so designated conforms to the standard of identity, if any, for such wine contained in the regulations under this section or, if there is no such standard, to the trade understanding of such class or type.

"(2) DETERMINATION OF WHETHER NAME IS SEMI-GENERIC.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), a name of geographic significance, which is also the designation of a class or type of wine, shall be deemed to have become semi-generic only if so found by the Secretary.

"(B) CERTAIN NAMES TREATED AS SEMI-GENERIC.—The following names shall be treated as semi-generic: Angelica, Burgundy, Claret, Chablis, Champagne, Chianti, Malaga, Marsala, Madeira, Moselle, Port, Rhine Wine or Hock, Sauterne, Haut Sauterne, Sherry, Tokay.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

Subtitle B—Revisions Relating to Disasters

SEC. 911. AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER.

(a) IN GENERAL.—Chapter 77 is amended by inserting after section 7508 the following new section:

"SEC. 7508A. AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER.

"(a) IN GENERAL.—In the case of a taxpayer determined by the Secretary to be affected by a Presidentially declared disaster (as defined by section 1033(h)(3)), the Secretary may prescribe regulations under which a period of up to 90 days may be disregarded in determining, under the internal revenue laws, in respect of any tax liability (including any penalty, additional amount, or addition to the tax) of such taxpayer—

"(1) whether any of the acts described in paragraph (1) of section 7508(a) were performed within the time prescribed therefor, and

"(2) the amount of any credit or refund.

"(b) INTEREST ON OVERPAYMENTS AND UNDERPAYMENTS.—Subsection (a) shall not apply for the purpose of determining interest on any overpayment or underpayment.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 77 is amended by inserting after the item relating to section 7508 the following new item:

"Sec. 7508A. Authority to postpone certain tax-related deadlines by reason of presidentially declared disaster.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to any period for performing an act that has not expired before the date of the enactment of this Act.

SEC. 912. USE OF CERTAIN APPRAISALS TO ESTABLISH AMOUNT OF DISASTER LOSS.

(a) IN GENERAL.—Subsection (i) of section 165 is amended by adding at the end the following new paragraph:

"(4) USE OF DISASTER LOAN APPRAISALS TO ESTABLISH AMOUNT OF LOSS.—Nothing in this title shall be construed to prohibit the Secretary from prescribing regulations or other guidance under which an appraisal for the purpose of obtaining a loan of Federal funds or a loan guarantee from the Federal Government as a result of a Presidentially declared disaster (as defined by section 1033(h)(3)) may be used to establish the amount of any loss described in paragraph (1) or (2).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 913. TREATMENT OF LIVESTOCK SOLD ON ACCOUNT OF WEATHER-RELATED CONDITIONS.

(a) DEFERRAL OF INCOME INCLUSION.—Subsection (e) of section 451 (relating to special rules for proceeds from livestock sold on account of drought) is amended—

(1) by striking "drought conditions, and that these drought conditions" in paragraph (1) and inserting "drought, flood, or other weather-related conditions, and that such conditions"; and

(2) by inserting ", FLOOD, OR OTHER WEATHER-RELATED CONDITIONS" after "DROUGHT" in the subsection heading.

(b) INVOLUNTARY CONVERSIONS.—Subsection (e) of section 1033 (relating to livestock sold on account of drought) is amended—

(1) by inserting ", flood, or other weather-related conditions" before the period at the end thereof; and

(2) by inserting ", FLOOD, OR OTHER WEATHER-RELATED CONDITIONS" after "DROUGHT" in the subsection heading.

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

SEC. 914. MORTGAGE FINANCING FOR RESIDENCES LOCATED IN DISASTER AREAS.

Subsection (k) of section 143 (relating to mortgage revenue bonds; qualified mortgage bond and qualified veteran's mortgage bond) is amended by adding at the end the following new paragraph:

"(11) SPECIAL RULES FOR RESIDENCES LOCATED IN DISASTER AREAS.—In the case of a residence located in an area determined by the President to warrant assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (as in effect on the date of the enactment of the Taxpayer Relief Act of 1997), this section shall be

applied with the following modifications to financing provided with respect to such residence within 2 years after the date of the disaster declaration:

“(A) Subsection (d) (relating to 3-year requirement) shall not apply.

“(B) Subsections (e) and (f) (relating to purchase price requirement and income requirement) shall be applied as if such residence were a targeted area residence.

The preceding sentence shall apply only with respect to bonds issued after December 31, 1996, and before January 1, 1999.”.

SEC. 915. ABATEMENT OF INTEREST ON UNDERPAYMENTS BY TAXPAYERS IN PRESIDENTIALLY DECLARED DISASTER AREAS.

(a) IN GENERAL.—If the Secretary of the Treasury extends for any period the time for filing income tax returns under section 6081 of the Internal Revenue Code of 1986 and the time for paying income tax with respect to such returns under section 6161 of such Code (and waives any penalties relating to the failure to so file or so pay) for any individual located in a Presidentially declared disaster area, the Secretary shall, notwithstanding section 7508A(b) of such Code, abate for such period the assessment of any interest prescribed under section 6601 of such Code on such income tax.

(b) PRESIDENTIALLY DECLARED DISASTER AREA.—For purposes of subsection (a), the term “Presidentially declared disaster area” means, with respect to any individual, any area which the President has determined during 1997 warrants assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

(c) INDIVIDUAL.—For purposes of this section, the term “individual” shall not include any estate or trust.

(d) EFFECTIVE DATE.—This section shall apply to disasters declared after December 31, 1996.

Subtitle C—Provisions Relating to Employment Taxes

SEC. 921. CLARIFICATION OF STANDARD TO BE USED IN DETERMINING EMPLOYMENT TAX STATUS OF SECURITIES BROKERS.

(a) IN GENERAL.—In determining for purposes of the Internal Revenue Code of 1986 whether a registered representative of a securities broker-dealer is an employee (as defined in section 3121(d) of the Internal Revenue Code of 1986), no weight shall be given to instructions from the service recipient which are imposed only in compliance with investor protection standards imposed by the Federal Government, any State government, or a governing body pursuant to a delegation by a Federal or State agency.

(b) EFFECTIVE DATE.—Subsection (a) shall apply to services performed after December 31, 1997.

SEC. 922. CLARIFICATION OF EXEMPTION FROM SELF-EMPLOYMENT TAX FOR CERTAIN TERMINATION PAYMENTS RECEIVED BY FORMER INSURANCE SALESMEN.

(a) INTERNAL REVENUE CODE.—Section 1402 (relating to definitions) is amended by adding at the end the following new subsection:

"(k) CODIFICATION OF TREATMENT OF CERTAIN TERMINATION PAYMENTS RECEIVED BY FORMER INSURANCE SALESMEN.—Nothing in subsection (a) shall be construed as including in the net earnings from self-employment of an individual any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if—

"(1) such amount is received after termination of such individual's agreement to perform such services for such company,

"(2) such individual performs no services for such company after such termination and before the close of such taxable year,

"(3) such individual enters into a covenant not to compete against such company which applies to at least the 1-year period beginning on the date of such termination, and

"(4) the amount of such payment—

"(A) depends primarily on policies sold by or credited to the account of such individual during the last year of such agreement or the extent to which such policies remain in force for some period after such termination, or both, and

"(B) does not depend to any extent on length of service or overall earnings from services performed for such company (without regard to whether eligibility for payment depends on length of service).".

(b) SOCIAL SECURITY ACT.—Section 211 of the Social Security Act is amended by adding at the end the following new subsection:

"Codification of Treatment of Certain Termination Payments Received by Former Insurance Salesmen

"(j) Nothing in subsection (a) shall be construed as including in the net earnings from self-employment of an individual any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if—

"(1) such amount is received after termination of such individual's agreement to perform such services for such company,

"(2) such individual performs no services for such company after such termination and before the close of such taxable year,

"(3) such individual enters into a covenant not to compete against such company which applies to at least the 1-year period beginning on the date of such termination, and

"(4) the amount of such payment—

"(A) depends primarily on policies sold by or credited to the account of such individual during the last year of such agreement or the extent to which such policies remain in force for some period after such termination, or both, and

"(B) does not depend to any extent on length of service or overall earnings from services performed for such company (without regard to whether eligibility for payment depends on length of service).".

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

Subtitle D—Provisions Relating to Small Businesses

SEC. 931. WAIVER OF PENALTY THROUGH JUNE 30, 1998, ON SMALL BUSINESSES FAILING TO MAKE ELECTRONIC FUND TRANSFERS OF TAXES.

No penalty shall be imposed under the Internal Revenue Code of 1986 solely by reason of a failure by a person to use the electronic fund transfer system established under section 6302(h) of such Code if—

(1) such person is a member of a class of taxpayers first required to use such system on or after July 1, 1997, and

(2) such failure occurs before July 1, 1998.

SEC. 932. CLARIFICATION OF TREATMENT OF HOME OFFICE USE FOR ADMINISTRATIVE AND MANAGEMENT ACTIVITIES.

(a) IN GENERAL.—Paragraph (1) of section 280A(c) is amended by adding at the end the following new sentence: "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 business where the taxpayer conducts substantial administrative or management activities of such trade or business.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1998.

SEC. 933. AVERAGING OF FARM INCOME OVER 3 YEARS.

(a) IN GENERAL.—Subchapter Q of chapter 1 (relating to readjustment of tax between years and special limitations) is amended by adding the following new part:

"PART I—INCOME AVERAGING

"SEC. 1301. AVERAGING OF FARM INCOME.

"(a) IN GENERAL.—At the election of an individual engaged in a farming business, the tax imposed by section 1 for such taxable year shall be equal to the sum of—

"(1) a tax computed under such section on taxable income reduced by elected farm income, plus

"(2) the increase in tax imposed by section 1 which would result if taxable income for each of the 3 prior taxable years were increased by an amount equal to one-third of the elected farm income.

Any adjustment under this section for any taxable year shall be taken into account in applying this section for any subsequent taxable year.

"(b) DEFINITIONS.—In this section—

"(1) ELECTED FARM INCOME.—

"(A) IN GENERAL.—The term 'elected farm income' means so much of the taxable income for the taxable year—

"(i) which is attributable to any farming business; and

"(ii) which is specified in the election under subsection (a).

"(B) TREATMENT OF GAINS.—For purposes of subparagraph (A), gain from the sale or other disposition of property (other than land) regularly used by the taxpayer in such a farming business for a substantial period shall be treated as attributable to such a farming business.

"(2) INDIVIDUAL.—The term 'individual' shall not include any estate or trust.

"(3) FARMING BUSINESS.—The term 'farming business' has the meaning given such term by section 263A(e)(4).

"(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations regarding—

"(1) the order and manner in which items of income, gain, deduction, or loss, or limitations on tax, shall be taken into account in computing the tax imposed by this chapter on the income of any taxpayer to whom this section applies for any taxable year, and

"(2) the treatment of any short taxable year.".

(b) CLERICAL AMENDMENT.—The table of parts for such subchapter Q is amended by inserting before the item relating to part II the following new item:

"Part I. Income averaging.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1997, and before January 1, 2001.

SEC. 934. INCREASE IN DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—The table contained in section 162(l)(1)(B) is amended to read as follows:

"For taxable years beginning in calendar year—	*The applicable percentage is—*
1997	*40*
1998 and 1999	*45*
2000 and 2001	*50*
2002	*60*
2003 through 2005	*80*
2006	*90*
2007 and thereafter	*100.".*

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

SEC. 935. MORATORIUM ON CERTAIN REGULATIONS.

No temporary or final regulation with respect to the definition of a limited partner under section 1402(a)(13) of the Internal Revenue Code of 1986 may be issued or made effective before July 1, 1998.

Subtitle E—Brownfields

SEC. 941. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

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

"SEC. 198. EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

"(a) IN GENERAL.—A taxpayer may elect to treat any qualified environmental remediation expenditure which is paid or incurred by the taxpayer as an expense which is not chargeable to capital account. Any expenditure which is so treated shall be allowed as a deduction for the taxable year in which it is paid or incurred.

"(b) QUALIFIED ENVIRONMENTAL REMEDIATION EXPENDITURE.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified environmental remediation expenditure' means any expenditure—

"(A) which is otherwise chargeable to capital account, and

"(B) which is paid or incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site.

"(2) SPECIAL RULE FOR EXPENDITURES FOR DEPRECIABLE PROPERTY.—Such term shall not include any expenditure for the acquisition of property of a character subject to the allowance for depreciation which is used in connection with the abatement or control of hazardous substances at a qualified contaminated site; except that the portion of the allowance under section 167 for such property which is otherwise allocated to such site shall be treated as a qualified environmental remediation expenditure.

"(c) QUALIFIED CONTAMINATED SITE.—For purposes of this section—

"(1) QUALIFIED CONTAMINATED SITE.—

"(A) IN GENERAL.—The term 'qualified contaminated site' means any area—

"(i) which is held by the taxpayer for use in a trade or business or for the production of income, or which is property described in section 1221(1) in the hands of the taxpayer,

"(ii) which is within a targeted area, and

"(iii) at or on which there has been a release (or threat of release) or disposal of any hazardous substance.

"(B) TAXPAYER MUST RECEIVE STATEMENT FROM STATE ENVIRONMENTAL AGENCY.—An area shall be treated as a qualified contaminated site with respect to expenditures paid or incurred during any taxable year only if the taxpayer receives a statement from the appropriate agency of the State in which such area is located that such area meets the requirements of clauses (ii) and (iii) of subparagraph (A).

"(C) APPROPRIATE STATE AGENCY.—For purposes of subparagraph (B), the chief executive officer of each State may, in consultation with the Administrator of the Environmental Protection Agency, designate the appropriate State environmental agency within 60 days of the date of the enactment of this section. If the chief executive officer of a State has not designated an appropriate State environmental agency within such 60-day period, the appropriate

environmental agency for such State shall be designated by the Administrator of the Environmental Protection Agency.

"(2) TARGETED AREA.—

"(A) IN GENERAL.—The term 'targeted area' means—

"(i) any population census tract with a poverty rate of not less than 20 percent,

"(ii) a population census tract with a population of less than 2,000 if—

"(I) more than 75 percent of such tract is zoned for commercial or industrial use, and

"(II) such tract is contiguous to 1 or more other population census tracts which meet the requirement of clause (i) without regard to this clause,

"(iii) any empowerment zone or enterprise community (and any supplemental zone designated on December 21, 1994), and

"(iv) any site announced before February 1, 1997, as being included as a brownfields pilot project of the Environmental Protection Agency.

"(B) NATIONAL PRIORITIES LISTED SITES NOT INCLUDED.—Such term shall not include any site which is on, or proposed for, the national priorities list under section 105(a)(8)(B) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (as in effect on the date of the enactment of this section).

"(C) CERTAIN RULES TO APPLY.—For purposes of this paragraph the rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

"(d) HAZARDOUS SUBSTANCE.—For purposes of this section—

"(1) IN GENERAL.—The term 'hazardous substance' means—

"(A) any substance which is a hazardous substance as defined in section 101(14) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, and

"(B) any substance which is designated as a hazardous substance under section 102 of such Act.

"(2) EXCEPTION.—Such term shall not include any substance with respect to which a removal or remedial action is not permitted under section 104 of such Act by reason of subsection (a)(3) thereof.

"(e) DEDUCTION RECAPTURED AS ORDINARY INCOME ON SALE, ETC.—Solely for purposes of section 1245, in the case of property to which a qualified environmental remediation expenditure would have been capitalized but for this section—

"(1) the deduction allowed by this section for such expenditure shall be treated as a deduction for depreciation, and

"(2) such property (if not otherwise section 1245 property) shall be treated as section 1245 property solely for purposes of applying section 1245 to such deduction.

"(f) COORDINATION WITH OTHER PROVISIONS.—Sections 280B and 468 shall not apply to amounts which are treated as expenses under this section.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

"(h) TERMINATION.—This section shall not apply to expenditures paid or incurred after December 31, 2000.".

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

"Sec. 198. Expensing of environmental remediation costs.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to expenditures paid or incurred after the date of the enactment of this Act, in taxable years ending after such date.

Subtitle F—Empowerment Zones, Enterprise Communities, Brownfields, and Community Development Financial Institutions

CHAPTER 1—ADDITIONAL EMPOWERMENT ZONES

SEC. 951. ADDITIONAL EMPOWERMENT ZONES.

(a) IN GENERAL.—Paragraph (2) of section 1391(b) (relating to designations of empowerment zones and enterprise communities) is amended—

(1) by striking "9" and inserting "11",

(2) by striking "6" and inserting "8", and

(3) by striking "750,000" and inserting "1,000,000".

(b) SPECIAL RULES FOR APPLICATION OF EMPLOYMENT CREDIT.—Subsection (b) of section 1396 (relating to empowerment zone employment credit) is amended—

(1) by striking so much of the subsection as precedes the table and inserting the following:

"(b) APPLICABLE PERCENTAGE.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (2), the term 'applicable percentage' means the percentage determined in accordance with the following table:", and

(2) by adding at the end the following new paragraph:

"(2) SPECIAL RULE.—With respect to each empowerment zone designated pursuant to the amendments made by the Taxpayer Relief Act of 1997 to section 1391(b)(2), the following table shall apply in lieu of the table in paragraph (1):

"In the case of wages paid or incurred during calendar year—	*The applicable percentage is:*
2000 through 2004	*20*
2005	*15*
2006	*10*
2007	*5."*

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act, except that designations of new empowerment zones made pursuant to such amendments shall be made during the 180-day period beginning on

the date of the enactment of this Act. No designation pursuant to such amendments shall take effect before January 1, 2000.

CHAPTER 2—NEW EMPOWERMENT ZONES

SEC. 952. DESIGNATION OF NEW EMPOWERMENT ZONES.

(a) IN GENERAL.—Section 1391 (relating to designation procedure for empowerment zones and enterprise communities) is amended by adding at the end the following new subsection:

"(g) ADDITIONAL DESIGNATIONS PERMITTED.—

"(1) IN GENERAL.—In addition to the areas designated under subsection (a), the appropriate Secretaries may designate in the aggregate an additional 20 nominated areas as empowerment zones under this section, subject to the availability of eligible nominated areas. Of that number, not more than 15 may be designated in urban areas and not more than 5 may be designated in rural areas.

"(2) PERIOD DESIGNATIONS MAY BE MADE AND TAKE EFFECT.—A designation may be made under this subsection after the date of the enactment of this subsection and before January 1, 1999.

"(3) MODIFICATIONS TO ELIGIBILITY CRITERIA, ETC.—

"(A) POVERTY RATE REQUIREMENT.—

"(i) IN GENERAL.—A nominated area shall be eligible for designation under this subsection only if the poverty rate for each population census tract within the nominated area is not less than 20 percent and the poverty rate for at least 90 percent of the population census tracts within the nominated area is not less than 25 percent.

"(ii) TREATMENT OF CENSUS TRACTS WITH SMALL POPULATIONS.—A population census tract with a population of less than 2,000 shall be treated as having a poverty rate of not less than 25 percent if—

"(I) more than 75 percent of such tract is zoned for commercial or industrial use, and

"(II) such tract is contiguous to 1 or more other population census tracts which have a poverty rate of not less than 25 percent (determined without regard to this clause).

"(iii) EXCEPTION FOR DEVELOPABLE SITES.—Clause (i) shall not apply to up to 3 noncontiguous parcels in a nominated area which may be developed for commercial or industrial purposes. The aggregate area of noncontiguous parcels to which the preceding sentence applies with respect to any nominated area shall not exceed 2,000 acres.

"(iv) CERTAIN PROVISIONS NOT TO APPLY.—Section 1392(a)(4) (and so much of paragraphs (1) and (2) of section 1392(b) as relate to section 1392(a)(4)) shall not apply to an area nominated for designation under this subsection.

"(v) SPECIAL RULE FOR RURAL EMPOWERMENT ZONE.—The Secretary of Agriculture may designate not more than 1 empowerment zone in a rural area with-

out regard to clause (i) if such area satisfies emigration criteria specified by the Secretary of Agriculture.

"(B) SIZE LIMITATION.—

"(i) IN GENERAL.—The parcels described in subparagraph (A)(iii) shall not be taken into account in determining whether the requirement of subparagraph (A) or (B) of section 1392(a)(3) is met.

"(ii) SPECIAL RULE FOR RURAL AREAS.—If a population census tract (or equivalent division under section 1392(b)(4)) in a rural area exceeds 1,000 square miles or includes a substantial amount of land owned by the Federal, State, or local government, the nominated area may exclude such excess square mileage or governmentally owned land and the exclusion of that area will not be treated as violating the continuous boundary requirement of section 1392(a)(3)(B).

"(C) AGGREGATE POPULATION LIMITATION.—The aggregate population limitation under the last sentence of subsection (b)(2) shall not apply to a designation under paragraph (1)(B).

"(D) PREVIOUSLY DESIGNATED ENTERPRISE COMMUNITIES MAY BE INCLUDED.—Subsection (e)(5) shall not apply to any enterprise community designated under subsection (a) that is also nominated for designation under this subsection.

"(E) INDIAN RESERVATIONS MAY BE NOMINATED.—

"(i) IN GENERAL.—Section 1393(a)(4) shall not apply to an area nominated for designation under this subsection.

"(ii) SPECIAL RULE.—An area in an Indian reservation shall be treated as nominated by a State and a local government if it is nominated by the reservation governing body (as determined by the Secretary of Interior)."

(b) EMPLOYMENT CREDIT NOT TO APPLY TO NEW EMPOWERMENT ZONES.—Section 1396 (relating to empowerment zone employment credit) is amended by adding at the end the following new subsection:

"(e) CREDIT NOT TO APPLY TO EMPOWERMENT ZONES DESIGNATED UNDER SECTION 1391(g).—This section shall be applied without regard to any empowerment zone designated under section 1391(g)."

(c) INCREASED EXPENSING UNDER SECTION 179 NOT TO APPLY IN DEVELOPABLE SITES.—Section 1397A (relating to increase in expensing under section 179) is amended by adding at the end the following new subsection:

"(c) LIMITATION.—For purposes of this section, qualified zone property shall not include any property substantially all of the use of which is in any parcel described in section 1391(g)(3)(A)(iii)."

(d) CONFORMING AMENDMENTS.—

(1) Subsections (e) and (f) of section 1391 are each amended by striking "subsection (a)" and inserting "this section".

(2) Section 1391(c) is amended by striking "this section" and inserting "subsection (a)".

SEC. 953. VOLUME CAP NOT TO APPLY TO ENTERPRISE ZONE FACILITY BONDS WITH RESPECT TO NEW EMPOWERMENT ZONES.

(a) IN GENERAL.—Section 1394 (relating to tax-exempt enterprise zone facility bonds) is amended by adding at the end the following new subsection:

“(f) BONDS FOR EMPOWERMENT ZONES DESIGNATED UNDER SECTION 1391(g).—

“(1) IN GENERAL.—In the case of a new empowerment zone facility bond—

“(A) such bond shall not be treated as a private activity bond for purposes of section 146, and

“(B) subsection (c) of this section shall not apply.

“(2) LIMITATION ON AMOUNT OF BONDS.—

“(A) IN GENERAL.—Paragraph (1) shall apply to a new empowerment zone facility bond only if such bond is designated for purposes of this subsection by the local government which nominated the area to which such bond relates.

“(B) LIMITATION ON BONDS DESIGNATED.—The aggregate face amount of bonds which may be designated under subparagraph (A) with respect to any empowerment zone shall not exceed—

“(i) $60,000,000 if such zone is in a rural area,

“(ii) $130,000,000 if such zone is in an urban area and the zone has a population of less than 100,000, and

“(iii) $230,000,000 if such zone is in an urban area and the zone has a population of at least 100,000.

“(C) SPECIAL RULES.—

“(i) COORDINATION WITH LIMITATION IN SUBSECTION (c).—Bonds to which paragraph (1) applies shall not be taken into account in applying the limitation of subsection (c) to other bonds.

“(ii) CURRENT REFUNDING NOT TAKEN INTO ACCOUNT.—In the case of a refunding (or series of refundings) of a bond designated under this paragraph, the refunding obligation shall be treated as designated under this paragraph (and shall not be taken into account in applying subparagraph (B)) if—

“(I) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

“(II) the refunded bond is redeemed not later than 90 days after the date of issuance of the refunding bond.

“(3) NEW EMPOWERMENT ZONE FACILITY BOND.—For purposes of this subsection, the term ‘new empowerment zone facility bond’ means any bond which would be described in subsection (a) if only empowerment zones designated under section 1391(g) were taken into account under sections 1397B and 1397C.”

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

SEC. 954. MODIFICATION TO ELIGIBILITY CRITERIA FOR DESIGNATION OF FUTURE ENTERPRISE ZONES IN ALASKA OR HAWAII.

Section 1392 (relating to eligibility criteria) is amended by adding at the end the following new subsection:

"(d) SPECIAL ELIGIBILITY FOR NOMINATED AREAS LOCATED IN ALASKA OR HAWAII.—A nominated area in Alaska or Hawaii shall be treated as meeting the requirements of paragraphs (2), (3), and (4) of subsection (a) if for each census tract or block group within such area 20 percent or more of the families have income which is 50 percent or less of the statewide median family income (as determined under section 143).".

CHAPTER 3—TREATMENT OF EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES

SEC. 955. MODIFICATIONS TO ENTERPRISE ZONE FACILITY BOND RULES FOR ALL EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES.

(a) MODIFICATIONS RELATING TO ENTERPRISE ZONE BUSINESS.—Paragraph (3) of section 1394(b) (defining enterprise zone business) is amended to read as follows:

"(3) ENTERPRISE ZONE BUSINESS.—

"(A) IN GENERAL.—Except as modified in this paragraph, the term 'enterprise zone business' has the meaning given such term by section 1397B.

"(B) MODIFICATIONS.—In applying section 1397B for purposes of this section—

"(i) BUSINESSES IN ENTERPRISE COMMUNITIES ELIGIBLE.—References in section 1397B to empowerment zones shall be treated as including references to enterprise communities.

"(ii) WAIVER OF REQUIREMENTS DURING STARTUP PERIOD.—A business shall not fail to be treated as an enterprise zone business during the startup period if—

"(I) as of the beginning of the startup period, it is reasonably expected that such business will be an enterprise zone business (as defined in section 1397B as modified by this paragraph) at the end of such period, and

"(II) such business makes bona fide efforts to be such a business.

"(iii) REDUCED REQUIREMENTS AFTER TESTING PERIOD.—A business shall not fail to be treated as an enterprise zone business for any taxable year beginning after the testing period by reason of failing to meet any requirement of subsection (b) or (c) of section 1397B if at least 35 percent of the employees of such business for such year are residents of an empowerment zone or an enterprise community. The preceding sentence shall not apply to any business which is not a qualified business by reason of paragraph (1), (4), or (5) of section 1397B(d).

"(C) DEFINITIONS RELATING TO SUBPARAGRAPH (B).—For purposes of subparagraph (B)—

"(i) STARTUP PERIOD.—The term 'startup period' means, with respect to any property being provided for any business, the period before the first taxable year beginning more than 2 years after the later of—

"(I) the date of issuance of the issue providing such property, or

"(II) the date such property is first placed in service after such issuance (or, if earlier, the date which is 3 years after the date described in subclause (I)).

"(ii) TESTING PERIOD.—The term 'testing period' means the first 3 taxable years beginning after the startup period.

"(D) PORTIONS OF BUSINESS MAY BE ENTERPRISE ZONE BUSINESS.—The term 'enterprise zone business' includes any trades or businesses which would qualify as an enterprise zone business (determined after the modifications of subparagraph (B)) if such trades or businesses were separately incorporated."

(b) MODIFICATIONS RELATING TO QUALIFIED ZONE PROPERTY.—Paragraph (2) of section 1394(b) (defining qualified zone property) is amended to read as follows:

"(2) QUALIFIED ZONE PROPERTY.—The term 'qualified zone property' has the meaning given such term by section 1397C; except that—

"(A) the references to empowerment zones shall be treated as including references to enterprise communities, and

"(B) section 1397C(a)(2) shall be applied by substituting 'an amount equal to 15 percent of the adjusted basis' for 'an amount equal to the adjusted basis'."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

SEC. 956. MODIFICATIONS TO ENTERPRISE ZONE BUSINESS DEFINITION FOR ALL EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES.

(a) IN GENERAL.—Section 1397B (defining enterprise zone business) is amended—

(1) by striking "80 percent" in subsections (b)(2) and (c)(1) and inserting "50 percent",

(2) by striking "substantially all" each place it appears in subsections (b) and (c) and inserting "a substantial portion",

(3) by striking ", and exclusively related to," in subsections (b)(4) and (c)(3),

(4) by adding at the end of subsection (d)(2) the following new flush sentence:

"For purposes of subparagraph (B), the lessor of the property may rely on a lessee's certification that such lessee is an enterprise zone business.",

(5) by striking "substantially all" in subsection (d)(3) and inserting "at least 50 percent", and

(6) by adding at the end the following new subsection:

"(f) TREATMENT OF BUSINESSES STRADDLING CENSUS TRACT LINES.—For purposes of this section, if—

"(1) a business entity or proprietorship uses real property located within an empowerment zone,

"(2) the business entity or proprietorship also uses real property located outside the empowerment zone,

"(3) the amount of real property described in paragraph (1) is substantial compared to the amount of real property described in paragraph (2), and

"(4) the real property described in paragraph (2) is contiguous to part or all of the real property described in paragraph (1),

then all the services performed by employees, all business activities, all tangible property, and all intangible property of the business entity or proprietorship that occur in or is located on the real property described in paragraphs (1) and (2) shall be treated as occurring or situated in an empowerment zone."

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning on or after the date of the enactment of this Act.

(2) SPECIAL RULE FOR ENTERPRISE ZONE FACILITY BONDS.—For purposes of section 1394(b) of the Internal Revenue Code of 1986, the amendments made by this section shall apply to obligations issued after the date of the enactment of this Act.

Subtitle G—Other Provisions

SEC. 961. USE OF ESTIMATES OF SHRINKAGE FOR INVENTORY ACCOUNTING.

(a) IN GENERAL.—Section 471 (relating to general rule for inventories) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) ESTIMATES OF INVENTORY SHRINKAGE PERMITTED.—A method of determining inventories shall not be treated as failing to clearly reflect income solely because it utilizes estimates of inventory shrinkage that are confirmed by a physical count only after the last day of the taxable year if—

"(1) the taxpayer normally does a physical count of inventories at each location on a regular and consistent basis, and

"(2) the taxpayer makes proper adjustments to such inventories and to its estimating methods to the extent such estimates are greater than or less than the actual shrinkage.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to taxable years ending after the date of the enactment of this Act.

(2) COORDINATION WITH SECTION 481.—In the case of any taxpayer permitted by this section to change its method of accounting to a permissible method for any taxable year—

(A) such changes shall be treated as initiated by the taxpayer,

(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the period for taking into account the adjustments under section 481 by reason of such change shall be 4 years.

SEC. 962. ASSIGNMENT OF WORKMEN'S COMPENSATION LIABILITY ELIGIBLE FOR EXCLUSION RELATING TO PERSONAL INJURY LIABILITY ASSIGNMENTS.

(a) IN GENERAL.—Subsection (c) of section 130 (relating to certain personal injury liability assignments) is amended—

(1) by inserting ", or as compensation under any workmen's compensation act," after "(whether by suit or agreement)" in the material preceding paragraph (1),

(2) by inserting "or the workmen's compensation claim," after "agreement," in paragraph (1), and

(3) by striking "section 104(a)(2)" in paragraph (2)(D) and inserting "paragraph (1) or (2) of section 104(a)".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to claims under workmen's compensation acts filed after the date of the enactment of this Act.

SEC. 963. TAX-EXEMPT STATUS FOR CERTAIN STATE WORKER'S COMPENSATION ACT COMPANIES.

(a) IN GENERAL.—Section 501(c)(27) (relating to membership organizations under workmen's compensation acts) is amended by adding at the end the following:

"(B) Any organization (including a mutual insurance company) if—

"(i) such organization is created by State law and is organized and operated under State law exclusively to—

"(I) provide workmen's compensation insurance which is required by State law or with respect to which State law provides significant disincentives if such insurance is not purchased by an employer, and

"(II) provide related coverage which is incidental to workmen's compensation insurance,

"(ii) such organization must provide workmen's compensation insurance to any employer in the State (for employees in the State or temporarily assigned out-of-State) which seeks such insurance and meets other reasonable requirements relating thereto,

"(iii)(I) the State makes a financial commitment with respect to such organization either by extending the full faith and credit of the State to the initial debt of such organization or by providing the initial operating capital of such organization, and (II) in the case of periods after the date of enactment of this subparagraph, the assets of such organization revert to the State upon dissolution or State law does not permit the dissolution of such organization, and

"(iv) the majority of the board of directors or oversight body of such organization are appointed by the chief executive officer or other executive branch official of the State, by the State legislature, or by both.".

(b) CONFORMING AMENDMENTS.—Section 501(c)(27) is amended by inserting "(A)" after "(27)", by redesignating subparagraphs (A), (B), and (C) as clauses (i), (ii), and (iii), respectively, and by redesig-

nating clauses (i) and (ii) of subparagraphs (B) and (C) (before redesignation) as subclauses (I) and (II), respectively.

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

SEC. 964. ELECTION FOR 1987 PARTNERSHIPS TO CONTINUE EXCEPTION FROM TREATMENT OF PUBLICLY TRADED PARTNERSHIPS AS CORPORATIONS.

(a) IN GENERAL.—Section 7704 is amended by adding at the end the following new subsection:

"(g) EXCEPTION FOR ELECTING 1987 PARTNERSHIPS.—

"(1) IN GENERAL.—Subsection (a) shall not apply to an electing 1987 partnership.

"(2) ELECTING 1987 PARTNERSHIP.—For purposes of this subsection, the term 'electing 1987 partnership' means any publicly traded partnership if—

"(A) such partnership is an existing partnership (as defined in section 10211(c)(2) of the Revenue Reconciliation Act of 1987),

"(B) subsection (a) has not applied (and without regard to subsection (c)(1) would not have applied) to such partnership for all prior taxable years beginning after December 31, 1987, and before January 1, 1998, and

"(C) such partnership elects the application of this subsection, and consents to the application of the tax imposed by paragraph (3), for its first taxable year beginning after December 31, 1997.

A partnership which, but for this sentence, would be treated as an electing 1987 partnership shall cease to be so treated (and the election under subparagraph (C) shall cease to be in effect) as of the 1st day after December 31, 1997, on which there has been an addition of a substantial new line of business with respect to such partnership.

"(3) ADDITIONAL TAX ON ELECTING PARTNERSHIPS.—

"(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year on the income of each electing 1987 partnership a tax equal to 3.5 percent of such partnership's gross income for the taxable year from the active conduct of trades and businesses by the partnership.

"(B) ADJUSTMENTS IN THE CASE OF TIERED PARTNERSHIPS.—For purposes of this paragraph, in the case of a partnership which is a partner in another partnership, the gross income referred to in subparagraph (A) shall include the partnership's distributive share of the gross income of such other partnership from the active conduct of trades and businesses of such other partnership. A similar rule shall apply in the case of lower-tiered partnerships.

"(C) TREATMENT OF TAX.—For purposes of this title, the tax imposed by this paragraph shall be treated as imposed by chapter 1 other than for purposes of determining the amount of any credit allowable under chapter 1.

"(4) ELECTION.—An election and consent under this subsection shall apply to the taxable year for which made and all subsequent taxable years unless revoked by the partnership.

Such revocation may be made without the consent of the Secretary, but, once so revoked, may not be reinstated.".

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

SEC. 965. EXCLUSION FROM UNRELATED BUSINESS TAXABLE INCOME FOR CERTAIN SPONSORSHIP PAYMENTS.

(a) IN GENERAL.—Section 513 (relating to unrelated trade or business income) is amended by adding at the end the following new subsection:

"(i) TREATMENT OF CERTAIN SPONSORSHIP PAYMENTS.—

"(1) IN GENERAL.—The term 'unrelated trade or business' does not include the activity of soliciting and receiving qualified sponsorship payments.

"(2) QUALIFIED SPONSORSHIP PAYMENTS.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified sponsorship payment' means any payment made by any person engaged in a trade or business with respect to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgement of the name or logo (or product lines) of such person's trade or business in connection with the activities of the organization that receives such payment. Such a use or acknowledgement does not include advertising such person's products or services (including messages containing qualitative or comparative language, price information, or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use such products or services).

"(B) LIMITATIONS.—

"(i) CONTINGENT PAYMENTS.—The term 'qualified sponsorship payment' does not include any payment if the amount of such payment is contingent upon the level of attendance at one or more events, broadcast ratings, or other factors indicating the degree of public exposure to one or more events.

"(ii) SAFE HARBOR DOES NOT APPLY TO PERIODICALS AND QUALIFIED CONVENTION AND TRADE SHOW ACTIVITIES.—The term 'qualified sponsorship payment' does not include—

"(I) any payment which entitles the payor to the use or acknowledgement of the name or logo (or product lines) of the payor's trade or business in regularly scheduled and printed material published by or on behalf of the payee organization that is not related to and primarily distributed in connection with a specific event conducted by the payee organization, or

"(II) any payment made in connection with any qualified convention or trade show activity (as defined in subsection (d)(3)(B)).

"(3) ALLOCATION OF PORTIONS OF SINGLE PAYMENT.—For purposes of this subsection, to the extent that a portion of a payment would (if made as a separate payment) be a qualified

sponsorship payment, such portion of such payment and the other portion of such payment shall be treated as separate payments.”.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to payments solicited or received after December 31, 1997.

SEC. 966. ASSOCIATIONS OF HOLDERS OF TIMESHARE INTERESTS TO BE TAXED LIKE OTHER HOMEOWNERS ASSOCIATIONS.

(a) TIMESHARE ASSOCIATIONS INCLUDED AS HOMEOWNER ASSOCIATIONS.—

(1) IN GENERAL.—Paragraph (1) of section 528(c) (defining homeowners association) is amended—

(A) by striking “or a residential real estate management association” and inserting “, a residential real estate management association, or a timeshare association” in the material preceding subparagraph (A),

(B) by striking “or” at the end of clause (i) of subparagraph (B), by striking the period at the end of clause (ii) of subparagraph (B) and inserting “, or”, and by adding at the end of subparagraph (B) the following new clause:

“(iii) owners of timeshare rights to use, or timeshare ownership interests in, association property in the case of a timeshare association,”, and

(C) by inserting “and, in the case of a timeshare association, for activities provided to or on behalf of members of the association” before the comma at the end of subparagraph (C).

(2) TIMESHARE ASSOCIATION DEFINED.—Subsection (c) of section 528 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

“(4) TIMESHARE ASSOCIATION.—The term ‘timeshare association’ means any organization (other than a condominium management association) meeting the requirement of subparagraph (A) of paragraph (1) if any member thereof holds a timeshare right to use, or a timeshare ownership interest in, real property constituting association property.”.

(b) EXEMPT FUNCTION INCOME.—Paragraph (3) of section 528(d) is amended by striking “or” at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting “, or”, and by adding at the end the following new subparagraph:

“(C) owners of timeshare rights to use, or timeshare ownership interests in, real property in the case of a timeshare association.”.

(c) ASSOCIATION PROPERTY.—Paragraph (5) of section 528(c), as redesignated by subsection (a)(2), is amended by adding at the end the following new flush sentence:

“In the case of a timeshare association, such term includes property in which the timeshare association, or members of the association, have rights arising out of recorded easements, covenants, or other recorded instruments to use property related to the timeshare project.”.

(d) RATE OF TAX.—Subsection (b) of section 528 (relating to certain homeowners associations) is amended by inserting before the

period "(32 percent of such income in the case of a timeshare association)".

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

SEC. 967. ADDITIONAL ADVANCE REFUNDING OF CERTAIN VIRGIN ISLAND BONDS.

Subclause (I) of section 149(d)(3)(A)(i) of the Internal Revenue Code of 1986 shall not apply to the second advance refunding of any issue of the Virgin Islands which was first advance refunded before June 9, 1997, if the debt provisions of the refunding bonds are changed to repeal the priority first lien requirement of the refunded bonds.

SEC. 968. NONRECOGNITION OF GAIN ON SALE OF STOCK TO CERTAIN FARMERS' COOPERATIVES.

(a) IN GENERAL.—Section 1042 (relating to sales of stock to employee stock ownership plans or certain cooperatives) is amended by adding at the end the following new subsection:

"(g) APPLICATION OF SECTION TO SALES OF STOCK IN AGRICULTURAL REFINERS AND PROCESSORS TO ELIGIBLE FARM COOPERATIVES.—

"(1) IN GENERAL.—This section shall apply to the sale of stock of a qualified refiner or processor to an eligible farmers' cooperative.

"(2) QUALIFIED REFINER OR PROCESSOR.—For purposes of this subsection, the term 'qualified refiner or processor' means a domestic corporation—

"(A) substantially all of the activities of which consist of the active conduct of the trade or business of refining or processing agricultural or horticultural products, and

"(B) which, during the 1-year period ending on the date of the sale, purchases more than one-half of such products to be refined or processed from—

"(i) farmers who make up the eligible farmers' cooperative which is purchasing stock in the corporation in a transaction to which this subsection is to apply, or

"(ii) such cooperative.

"(3) ELIGIBLE FARMERS' COOPERATIVE.—For purposes of this section, the term 'eligible farmers' cooperative' means an organization to which part I of subchapter T applies and which is engaged in the marketing of agricultural or horticultural products.

"(4) SPECIAL RULES.—In applying this section to a sale to which paragraph (1) applies—

"(A) the eligible farmers' cooperative shall be treated in the same manner as a cooperative described in subsection (b)(1)(B),

"(B) subsection (b)(2) shall be applied by substituting '100 percent' for '30 percent' each place it appears,

"(C) the determination as to whether any stock in the domestic corporation is a qualified security shall be made without regard to whether the stock is an employer security or to subsection (c)(1)(A), and

"(D) paragraphs (2)(D) and (7) of subsection (c) shall not apply.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales after December 31, 1997.

SEC. 969. INCREASED DEDUCTIBILITY OF BUSINESS MEAL EXPENSES FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.

(a) IN GENERAL.—Section 274(n) (relating to only 50 percent of meal and entertainment expenses allowed as deduction) is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—

"(A) IN GENERAL.—In the case of any expenses for food or beverages consumed while away from home (within the meaning of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (1) shall be applied by substituting 'the applicable percentage' for '50 percent'.

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the term 'applicable percentage' means the percentage determined under the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
1998 or 1999	*55*
2000 or 2001	*60*
2002 or 2003	*65*
2004 or 2005	*70*
2006 or 2007	*75*
2008 or thereafter	*80.".*

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 970. CLARIFICATION OF DE MINIMIS FRINGE BENEFIT RULES TO NO-CHARGE EMPLOYEE MEALS.

(a) IN GENERAL.—Paragraph (2) of section 132(e) (defining de minimis fringe) is amended by adding at the end the following new sentence: "For purposes of subparagraph (B), an employee entitled under section 119 to exclude the value of a meal provided at such facility shall be treated as having paid an amount for such meal equal to the direct operating costs of the facility attributable to such meal.".

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

SEC. 971. EXEMPTION OF THE INCREMENTAL COST OF A CLEAN FUEL VEHICLE FROM THE LIMITS ON DEPRECIATION FOR VEHICLES.

(a) IN GENERAL.—Section 280F(a)(1) (relating to limiting depreciation on luxury automobiles) is amended by adding at the end the following new subparagraph:

"(C) SPECIAL RULE FOR CERTAIN CLEAN-FUEL PASSENGER AUTOMOBILES.—

"(i) MODIFIED AUTOMOBILES.—In the case of a passenger automobile which is propelled by a fuel which is not a clean-burning fuel and to which is installed qualified clean-fuel vehicle property (as defined in section 179A(c)(1)(A)) for purposes of permitting such vehicle to be propelled by a clean burning fuel (as defined

in section 179A(e)(1)), subparagraph (A) shall not apply to the cost of the installed qualified clean burning vehicle property.

"(ii) PURPOSE BUILT PASSENGER VEHICLES.—In the case of a purpose built passenger vehicle (as defined in section 4001(a)(2)(C)(ii)), each of the annual limitations specified in subparagraph (A) shall be tripled.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after the date of enactment of this Act and before January 1, 2005.

SEC. 972. TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT ON PERCENTAGE DEPLETION FOR MARGINAL PRODUCTION.

(a) IN GENERAL.—Paragraph (6) of section 613A(c) is amended by adding at the end the following new subparagraph:

"(H) TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT WITH RESPECT TO MARGINAL PRODUCTION.—The second sentence of subsection (a) of section 613 shall not apply to so much of the allowance for depletion as is determined under subparagraph (A) for any taxable year beginning after December 31, 1997, and before January 1, 2000.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 973. INCREASE IN STANDARD MILEAGE RATE EXPENSE DEDUCTION FOR CHARITABLE USE OF PASSENGER AUTOMOBILE.

(a) IN GENERAL.—Section 170(i) (relating to standard mileage rate for use of passenger automobile) is amended to read as follows:

"(i) STANDARD MILEAGE RATE FOR USE OF PASSENGER AUTOMOBILE.—For purposes of computing the deduction under this section for use of a passenger automobile, the standard mileage rate shall be 14 cents per mile.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 974. CLARIFICATION OF TREATMENT OF CERTAIN RECEIVABLES PURCHASED BY COOPERATIVE HOSPITAL SERVICE ORGANIZATIONS.

(a) IN GENERAL.—Subparagraph (A) of section 501(e)(1) is amended by inserting "(including the purchase of patron accounts receivable on a recourse basis)" after "billing and collection".

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

SEC. 975. DEDUCTION IN COMPUTING ADJUSTED GROSS INCOME FOR EXPENSES IN CONNECTION WITH SERVICE PERFORMED BY CERTAIN OFFICIALS.

(a) IN GENERAL.—Paragraph (2) of section 62(a) (defining adjusted gross income) is amended by adding at the end the following new subparagraph:

"(C) CERTAIN EXPENSES OF OFFICIALS.—The deductions allowed by section 162 which consist of expenses paid or incurred with respect to services performed by an official as an employee of a State or a political subdivision thereof in a position compensated in whole or in part on a fee basis.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenses paid or incurred in taxable years beginning after December 31, 1986.

SEC. 976. COMBINED EMPLOYMENT TAX REPORTING DEMONSTRATION PROJECT.

(a) IN GENERAL.—The Secretary of the Treasury shall provide for a demonstration project to assess the feasibility and desirability of expanding combined Federal and State tax reporting.

(b) DESCRIPTION OF DEMONSTRATION PROJECT.—The demonstration project under subsection (a) shall be—

(1) carried out between the Internal Revenue Service and the State of Montana for a period ending with the date which is 5 years after the date of the enactment of this Act,

(2) limited to the reporting of employment taxes, and

(3) limited to the disclosure of the taxpayer identity (as defined in section 6103(b)(6) of such Code) and the signature of the taxpayer.

(c) CONFORMING AMENDMENT.—Section 6103(d) is amended by adding at the end the following new paragraph:

"(5) DISCLOSURE FOR CERTAIN COMBINED REPORTING PROJECT.—The Secretary shall disclose taxpayer identities and signatures for purposes of the demonstration project described in section 967 of the Taxpayer Relief Act of 1997.".

SEC. 977. ELECTIVE CARRYBACK OF EXISTING CARRYOVERS OF NATIONAL RAILROAD PASSENGER CORPORATION.

(a) ELECTIVE CARRYBACK.—

(1) IN GENERAL.—If the National Railroad Passenger Corporation (in this section referred to as the "Corporation")—

(A) makes an election under this section for its first taxable year ending after September 30, 1997, and

(B) agrees to the conditions specified in paragraph (2),

then the Corporation shall be treated as having made a payment of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 for such first taxable year and the succeeding taxable year in an amount (for each such taxable year) equal to 50 percent of the amount determined under paragraph (3). Each such payment shall be treated as having been made by the Corporation on the last day prescribed by law (without regard to extensions) for filing its return of tax under chapter 1 of such Code for the taxable year to which such payment relates.

(2) CONDITIONS.—

(A) IN GENERAL.—This section shall only apply to the Corporation if it agrees (in such manner as the Secretary of the Treasury or his delegate may prescribe) to—

(i) except as provided in clause (ii), use any refund of the payment described in paragraph (1) (and any interest thereon) solely to finance qualified expenses of the Corporation, and

(ii) make the payments to non-Amtrak States as described in subsection (c).

(B) REPAYMENT.—

(i) IN GENERAL.—The Corporation shall repay to the United States any amount not used in accordance with this paragraph and any amount remaining unused as of January 1, 2010.

(ii) SPECIAL RULES.—For purposes of clause (i)—

(I) no amount shall be treated as remaining unused as of January 1, 2010, if it is obligated as of such date for a qualified expense, and

(II) the Corporation shall not be treated as failing to meet the requirements of clause (i) by reason of investing any amount for a temporary period.

(3) AMOUNT.—For purposes of paragraph (1)—

(A) IN GENERAL.—The amount determined under this paragraph shall be the lesser of—

(i) 35 percent of the Corporation's existing qualified carryovers, or

(ii) the Corporation's net tax liability for the carryback period.

(B) DOLLAR LIMIT.—Such amount shall not exceed $2,323,000,000.

(b) EXISTING QUALIFIED CARRYOVERS; NET TAX LIABILITY.—For purposes of this section—

(1) EXISTING QUALIFIED CARRYOVERS.—The term "existing qualified carryovers" means the aggregate of the amounts which are net operating loss carryovers under section 172(b) of the Internal Revenue Code of 1986 to the Corporation's first taxable year ending after September 30, 1997.

(2) NET TAX LIABILITY FOR CARRYBACK PERIOD.—

(A) IN GENERAL.—The Corporation's net tax liability for the carryback period is the aggregate of the net tax liability of the Corporation's railroad predecessors for taxable years in the carryback period.

(B) NET TAX LIABILITY.—The term "net tax liability" means, with respect to any taxable year, the amount of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 (or any corresponding provision of prior law) for such taxable year, reduced by the sum of the credits allowable against such tax under such Code (or any corresponding provision of prior law).

(C) CARRYBACK PERIOD.—The term "carryback period" means the period—

(i) which begins with the first taxable year of any railroad predecessor beginning before January 1, 1971, for which there is a net tax liability, and

(ii) which ends with the last taxable year of any railroad predecessor beginning before January 1, 1971.

(3) RAILROAD PREDECESSOR.—

(A) IN GENERAL.—The term "railroad predecessor" means—

(i) any railroad which entered into a contract under section 401 or 404(a) of the Rail Passenger Service Act of 1970 relieving the railroad of its entire responsibility for the provision of intercity rail passenger service, and

(ii) any predecessor thereof.

(B) CONSOLIDATED RETURNS.—If any railroad described in subparagraph (A) was a member of an affiliated group which filed a consolidated return for any taxable

year in the carryback period, each member of such group shall be treated as a railroad predecessor for such year.

(c) PAYMENTS TO NON-AMTRAK STATES.—

(1) IN GENERAL.—Within 30 days after receipt of any refund of any payment described in subsection (a)(1), the Corporation shall pay to each non-Amtrak State an amount equal to 1 percent of the amount of such refund.

(2) USE OF PAYMENT.—Each non-Amtrak State shall use the payment described in paragraph (1) (and any interest thereon) solely to finance qualified expenses of the State.

(3) REPAYMENT.—A non-Amtrak State shall pay to the United States—

(A) any portion of the payment received by the State under paragraph (1) (and any interest thereon) which is used for a purpose other than to finance qualified expenses of the State or which remains unused as of January 1, 2010, or

(B) if such State ceases to be a non-Amtrak State, the portion of such payment (and any interest thereon) remaining as of the date of the cessation.

Rules similar to the rules of subsection (a)(2)(B) shall apply for purposes of this paragraph.

(d) TAX CONSEQUENCES.—

(1) REDUCTION IN CARRYOVERS.—If the Corporation elects the application of this section, the Corporation's existing qualified carryovers shall be reduced by an amount equal to the amount determined under subsection (a)(3) divided by 0.35.

(2) REDUCTION IN TAX PAID BY RAILROAD PREDECESSORS.—

(A) IN GENERAL.—The Secretary of the Treasury or his delegate shall appropriately adjust the tax account of each railroad predecessor to reduce the net tax liability of such predecessor for taxable years beginning in the carryback period which is offset by reason of the application of this section.

(B) FIFO ORDERING RULE.—The Secretary shall make the adjustments under subparagraph (A) first for the earliest year in the carryback period and then for each subsequent year in such period.

(C) NO EFFECT ON OTHER TAXPAYERS.—In no event shall any taxpayer other than the Corporation be allowed a refund or credit by reason of this section.

(D) WAIVER OF LIMITATIONS.—If the adjustment under subparagraph (A) is barred by the operation of any law or rule of law, such law or rule of law shall be waived solely for purposes of making such adjustment.

(3) TAX TREATMENT OF EXPENDITURES.—With respect to any payment by the Corporation of qualified expenses described in subsection (e)(1)(A) during any taxable year from the amount of any refund of the payment described in subsection (a)(1)—

(A) no deduction shall be allowed to the Corporation with respect to any amount paid or incurred which is attributable to such amount, and

(B) the basis of any property shall be reduced by the portion of the cost of such property which is attributable to such amount.

(4) PAYMENTS TO A NON-AMTRAK STATE.—No deduction shall be allowed to the Corporation under chapter 1 of the Internal Revenue Code of 1986 for any payment to a non-Amtrak State required under subsection (a)(2)(A)(ii).

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

(1) QUALIFIED EXPENSES.—The term "qualified expenses" means expenses incurred for—

(A) in the case of the Corporation—

(i) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity passenger rail service, and

(ii) the payment of interest and principal on obligations incurred for such acquisition, upgrading, and maintenance, and

(B) in the case of a non-Amtrak State—

(i) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity passenger rail service,

(ii) the acquisition of equipment, rolling stock, and other capital improvements, the upgrading of maintenance facilities, and the maintenance of existing equipment, in intercity bus service,

(iii) the purchase of intercity passenger rail services from the Corporation, and

(iv) the payment of interest and principal on obligations incurred for such acquisition, upgrading, maintenance, and purchase.

In the case of a non-Amtrak State which provides its own intercity passenger rail service on the date of the enactment of this paragraph, subparagraph (B) shall be applied by only taking into account clauses (i) and (iv).

(2) NON-AMTRAK STATE.—The term "non-Amtrak State" means, with respect to any payment, any State which does not receive intercity passenger rail service from the Corporation at any time during the period beginning on the date of the enactment of this Act and ending on the date of the payment.

(f) AUTHORIZING REFORM REQUIRED.—

(1) IN GENERAL.—The Secretary of the Treasury shall not make payment of any refund of any payment described in subsection (a)(1) earlier than the date of the enactment of Federal legislation, other than legislation included in this section, which is enacted after July 29, 1997, and which authorizes reforms of the National Railroad Passenger Corporation.

(2) NO INTEREST.—Notwithstanding any other provision of law, if the payment of any refund is delayed by reason of paragraph (1), no interest shall accrue with respect to such payment prior to the 45th day following the date of the enactment of Federal legislation described in paragraph (1).

(3) ESTIMATE OF REVENUE.—For purposes of estimating revenues under budget reconciliation, the impact of this section on Federal revenues shall be determined without regard to this subsection.

Subtitle H—Extension of Duty-Free Treatment Under Generalized System of Preferences

SEC. 981. GENERALIZED SYSTEM OF PREFERENCES.

(a) EXTENSION OF DUTY-FREE TREATMENT UNDER SYSTEM.—Section 505 of the Trade Act of 1974 (19 U.S.C. 2465) is amended by striking "May 31, 1997" and inserting "June 30, 1998".

(b) RETROACTIVE APPLICATION FOR CERTAIN LIQUIDATIONS AND RELIQUIDATIONS.—

(1) IN GENERAL.—Notwithstanding section 514 of the Tariff Act of 1930 or any other provision of law and subject to paragraph (2), the entry—

(A) of any article to which duty-free treatment under title V of the Trade Act of 1974 would have applied if the entry had been made on May 31, 1997, and

(B) that was made after May 31, 1997, and before the date of the enactment of this Act,

shall be liquidated or reliquidated as free of duty, and the Secretary of the Treasury shall refund any duty paid with respect to such entry. As used in this subsection, the term "entry" includes a withdrawal from warehouse for consumption.

(2) REQUESTS.—Liquidation or reliquidation may be made under paragraph (1) with respect to an entry only if a request therefor is filed with the Customs Service, within 180 days after the date of the enactment of this Act, that contains sufficient information to enable the Customs Service—

(A) to locate the entry; or

(B) to reconstruct the entry if it cannot be located.

TITLE X—REVENUES

Subtitle A—Financial Products

SEC. 1001. CONSTRUCTIVE SALES TREATMENT FOR APPRECIATED FINANCIAL POSITIONS.

(a) IN GENERAL.—Part IV of subchapter P of chapter 1 is amended by adding at the end the following new section:

"SEC. 1259. CONSTRUCTIVE SALES TREATMENT FOR APPRECIATED FINANCIAL POSITIONS.

"(a) IN GENERAL.—If there is a constructive sale of an appreciated financial position—

"(1) the taxpayer shall recognize gain as if such position were sold, assigned, or otherwise terminated at its fair market value on the date of such constructive sale (and any gain shall

be taken into account for the taxable year which includes such date), and

"(2) for purposes of applying this title for periods after the constructive sale—

"(A) proper adjustment shall be made in the amount of any gain or loss subsequently realized with respect to such position for any gain taken into account by reason of paragraph (1), and

"(B) the holding period of such position shall be determined as if such position were originally acquired on the date of such constructive sale.

"(b) APPRECIATED FINANCIAL POSITION.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (2), the term 'appreciated financial position' means any position with respect to any stock, debt instrument, or partnership interest if there would be gain were such position sold, assigned, or otherwise terminated at its fair market value.

"(2) EXCEPTIONS.—The term 'appreciated financial position' shall not include—

"(A) any position with respect to debt if—

"(i) the debt unconditionally entitles the holder to receive a specified principal amount,

"(ii) the interest payments (or other similar amounts) with respect to such debt meet the requirements of clause (i) of section 860G(a)(1)(B), and

"(iii) such debt is not convertible (directly or indirectly) into stock of the issuer or any related person, and

"(B) any position which is marked to market under any provision of this title or the regulations thereunder.

"(3) POSITION.—The term 'position' means an interest, including a futures or forward contract, short sale, or option.

"(c) CONSTRUCTIVE SALE.—For purposes of this section—

"(1) IN GENERAL.—A taxpayer shall be treated as having made a constructive sale of an appreciated financial position if the taxpayer (or a related person)—

"(A) enters into a short sale of the same or substantially identical property,

"(B) enters into an offsetting notional principal contract with respect to the same or substantially identical property,

"(C) enters into a futures or forward contract to deliver the same or substantially identical property,

"(D) in the case of an appreciated financial position that is a short sale or a contract described in subparagraph (B) or (C) with respect to any property, acquires the same or substantially identical property, or

"(E) to the extent prescribed by the Secretary in regulations, enters into 1 or more other transactions (or acquires 1 or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

"(2) EXCEPTION FOR SALES OF NONPUBLICLY TRADED PROPERTY.—The term 'constructive sale' shall not include any contract for sale of any stock, debt instrument, or partnership interest which is not a marketable security (as defined in section 453(f)) if the contract settles within 1 year after the date such contract is entered into.

"(3) EXCEPTION FOR CERTAIN CLOSED TRANSACTIONS.—

"(A) IN GENERAL.—In applying this section, there shall be disregarded any transaction (which would otherwise be treated as a constructive sale) during the taxable year if—

"(i) such transaction is closed before the end of the 30th day after the close of such taxable year,

"(ii) the taxpayer holds the appreciated financial position throughout the 60-day period beginning on the date such transaction is closed, and

"(iii) at no time during such 60-day period is the taxpayer's risk of loss with respect to such position reduced by reason of a circumstance which would be described in section 246(c)(4) if references to stock included references to such position.

"(B) TREATMENT OF POSITIONS WHICH ARE REESTABLISHED.—If—

"(i) a transaction, which would otherwise be treated as a constructive sale of an appreciated financial position, is closed during the taxable year or during the 30 days thereafter, and

"(ii) another substantially similar transaction is entered into during the 60-day period beginning on the date the transaction referred to in clause (i) is closed—

"(I) which also would otherwise be treated as a constructive sale of such position,

"(II) which is closed before the 30th day after the close of the taxable year in which the transaction referred to in clause (i) occurs, and

"(III) which meets the requirements of clauses (ii) and (iii) of subparagraph (A),

the transaction referred to in clause (ii) shall be disregarded for purposes of determining whether the requirements of subparagraph (A)(iii) are met with respect to the transaction described in clause (i).

"(4) RELATED PERSON.—A person is related to another person with respect to a transaction if—

"(A) the relationship is described in section 267(b) or 707(b), and

"(B) such transaction is entered into with a view toward avoiding the purposes of this section.

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

"(1) FORWARD CONTRACT.—The term 'forward contract' means a contract to deliver a substantially fixed amount of property for a substantially fixed price.

"(2) OFFSETTING NOTIONAL PRINCIPAL CONTRACT.—The term 'offsetting notional principal contract' means, with respect to any property, an agreement which includes—

"(A) a requirement to pay (or provide credit for) all or substantially all of the investment yield (including appreciation) on such property for a specified period, and

"(B) a right to be reimbursed for (or receive credit for) all or substantially all of any decline in the value of such property.

"(e) SPECIAL RULES.—

"(1) TREATMENT OF SUBSEQUENT SALE OF POSITION WHICH WAS DEEMED SOLD.—If—

"(A) there is a constructive sale of any appreciated financial position,

"(B) such position is subsequently disposed of, and

"(C) at the time of such disposition, the transaction resulting in the constructive sale of such position is open with respect to the taxpayer or any related person,

solely for purposes of determining whether the taxpayer has entered into a constructive sale of any other appreciated financial position held by the taxpayer, the taxpayer shall be treated as entering into such transaction immediately after such disposition. For purposes of the preceding sentence, an assignment or other termination shall be treated as a disposition.

"(2) CERTAIN TRUST INSTRUMENTS TREATED AS STOCK.—For purposes of this section, an interest in a trust which is actively traded (within the meaning of section 1092(d)(1)) shall be treated as stock unless substantially all (by value) of the property held by the trust is debt described in subsection (b)(2)(A).

"(3) MULTIPLE POSITIONS IN PROPERTY.—If a taxpayer holds multiple positions in property, the determination of whether a specific transaction is a constructive sale and, if so, which appreciated financial position is deemed sold shall be made in the same manner as actual sales.

"(f) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.".

(b) ELECTION OF MARK TO MARKET FOR DEALERS IN COMMODITIES AND FOR TRADERS IN SECURITIES OR COMMODITIES.—Section 475 (relating to mark to market accounting method for dealers in securities) is amended by redesignating subsection (e) as subsection (g) and by inserting after subsection (d) the following new subsections:

"(e) ELECTION OF MARK TO MARKET FOR DEALERS IN COMMODITIES.—

"(1) IN GENERAL.—In the case of a dealer in commodities who elects the application of this subsection, this section shall apply to commodities held by such dealer in the same manner as this section applies to securities held by a dealer in securities.

"(2) COMMODITY.—For purposes of this subsection and subsection (f), the term 'commodity' means—

"(A) any commodity which is actively traded (within the meaning of section 1092(d)(1));

"(B) any notional principal contract with respect to any commodity described in subparagraph (A);

“(C) any evidence of an interest in, or a derivative instrument in, any commodity described in subparagraph (A) or (B), including any option, forward contract, futures contract, short position, and any similar instrument in such a commodity; and

“(D) any position which—

“(i) is not a commodity described in subparagraph (A), (B), or (C),

“(ii) is a hedge with respect to such a commodity, and

“(iii) is clearly identified in the taxpayer’s records as being described in this subparagraph before the close of the day on which it was acquired or entered into (or such other time as the Secretary may by regulations prescribe).

“(3) ELECTION.—An election under this subsection may be made without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

“(f) ELECTION OF MARK TO MARKET FOR TRADERS IN SECURITIES OR COMMODITIES.—

“(1) TRADERS IN SECURITIES.—

“(A) IN GENERAL.—In the case of a person who is engaged in a trade or business as a trader in securities and who elects to have this paragraph apply to such trade or business—

“(i) such person shall recognize gain or loss on any security held in connection with such trade or business at the close of any taxable year as if such security were sold for its fair market value on the last business day of such taxable year, and

“(ii) any gain or loss shall be taken into account for such taxable year.

Proper adjustment shall be made in the amount of any gain or loss subsequently realized for gain or loss taken into account under the preceding sentence. The Secretary may provide by regulations for the application of this subparagraph at times other than the times provided in this subparagraph.

“(B) EXCEPTION.—Subparagraph (A) shall not apply to any security—

“(i) which is established to the satisfaction of the Secretary as having no connection to the activities of such person as a trader, and

“(ii) which is clearly identified in such person’s records as being described in clause (i) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe).

If a security ceases to be described in clause (i) at any time after it was identified as such under clause (ii), subparagraph (A) shall apply to any changes in value of the security occurring after the cessation.

“(C) COORDINATION WITH SECTION 1259.—Any security to which subparagraph (A) applies and which was acquired in the normal course of the taxpayer’s activities as a trader in securities shall not be taken into account in applying section 1259 to any position to which subparagraph (A) does not apply.

“(D) OTHER RULES TO APPLY.—Rules similar to the rules of subsections (b)(4) and (d) shall apply to securities held by a person in any trade or business with respect to which an election under this paragraph is in effect.

“(2) TRADERS IN COMMODITIES.—In the case of a person who is engaged in a trade or business as a trader in commodities and who elects to have this paragraph apply to such trade or business, paragraph (1) shall apply to commodities held by such trader in connection with such trade or business in the same manner as paragraph (1) applies to securities held by a trader in securities.

“(3) ELECTION.—The elections under paragraphs (1) and (2) may be made separately for each trade or business and without the consent of the Secretary. Such an election, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.”.

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

“Sec. 1259. Constructive sales treatment for appreciated financial positions.”.

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to any constructive sale after June 8, 1997.

(2) EXCEPTION FOR SALES OF POSITIONS, ETC. HELD BEFORE JUNE 9, 1997.—If—

(A) before June 9, 1997, the taxpayer entered into any transaction which is a constructive sale of any appreciated financial position, and

(B) before the close of the 30-day period beginning on the date of the enactment of this Act or before such later date as may be specified by the Secretary of the Treasury, such transaction and position are clearly identified in the taxpayer’s records as offsetting,

such transaction and position shall not be taken into account in determining whether any other constructive sale after June 8, 1997, has occurred. The preceding sentence shall cease to apply as of the date such transaction is closed or the taxpayer ceases to hold such position.

(3) SPECIAL RULE.—In the case of a decedent dying after June 8, 1997, if—

(A) there was a constructive sale on or before such date of any appreciated financial position,

(B) the transaction resulting in such constructive sale of such position remains open (with respect to the decedent or any related person)—

(i) for not less than 2 years after the date of such transaction (whether such period is before or after June 8, 1997), and

(ii) at any time during the 3-year period ending on the date of the decedent's death, and

(C) such transaction is not closed within the 30-day period beginning on the date of the enactment of this Act,

then, for purposes of such Code, such position (and the transaction resulting in such constructive sale) shall be treated as property constituting rights to receive an item of income in respect of a decedent under section 691 of such Code. Section 1014(c) of such Code shall not apply to so much of such position's or property's value (as included in the decedent's estate for purposes of chapter 11 of such Code) as exceeds its fair market value as of the date such transaction is closed.

(4) ELECTION OF MARK TO MARKET BY SECURITIES TRADERS AND TRADERS AND DEALERS IN COMMODITIES.—

(A) IN GENERAL.—The amendments made by subsection (b) shall apply to taxable years ending after the date of the enactment of this Act.

(B) 4-YEAR SPREAD OF ADJUSTMENTS.—In the case of a taxpayer who elects under subsection (e) or (f) of section 475 of the Internal Revenue Code of 1986 (as added by this section) to change its method of accounting for the taxable year which includes the date of the enactment of this Act—

(i) any identification required under such subsection with respect to securities and commodities held on the date of the enactment of this Act shall be treated as timely made if made on or before the 30th day after such date of enactment, and

(ii) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of such Code shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.

SEC. 1002. LIMITATION ON EXCEPTION FOR INVESTMENT COMPANIES UNDER SECTION 351.

(a) IN GENERAL.—Paragraph (1) of section 351(e) (relating to exceptions) is amended by adding at the end the following: "For purposes of the preceding sentence, the determination of whether a company is an investment company shall be made—

"(A) by taking into account all stock and securities held by the company, and

"(B) by treating as stock and securities—

"(i) money,

"(ii) stocks and other equity interests in a corporation, evidences of indebtedness, options, forward or futures contracts, notional principal contracts and derivatives,

"(iii) any foreign currency,

"(iv) any interest in a real estate investment trust, a common trust fund, a regulated investment company, a publicly-traded partnership (as defined in section 7704(b)) or any other equity interest (other than in a

corporation) which pursuant to its terms or any other arrangement is readily convertible into, or exchangeable for, any asset described in any preceding clause, this clause or clause (v) or (viii),

“(v) except to the extent provided in regulations prescribed by the Secretary, any interest in a precious metal, unless such metal is used or held in the active conduct of a trade or business after the contribution,

“(vi) except as otherwise provided in regulations prescribed by the Secretary, interests in any entity if substantially all of the assets of such entity consist (directly or indirectly) of any assets described in any preceding clause or clause (viii),

“(vii) to the extent provided in regulations prescribed by the Secretary, any interest in any entity not described in clause (vi), but only to the extent of the value of such interest that is attributable to assets listed in clauses (i) through (v) or clause (viii), or

“(viii) any other asset specified in regulations prescribed by the Secretary.

The Secretary may prescribe regulations that, under appropriate circumstances, treat any asset described in clauses (i) through (v) as not so listed.”.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to transfers after June 8, 1997, in taxable years ending after such date.

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any transfer pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such transfer if such contract provides for the transfer of a fixed amount of property.

SEC. 1003. GAINS AND LOSSES FROM CERTAIN TERMINATIONS WITH RESPECT TO PROPERTY.

(a) APPLICATION OF CAPITAL TREATMENT TO PROPERTY OTHER THAN PERSONAL PROPERTY.—

(1) IN GENERAL.—Paragraph (1) of section 1234A (relating to gains and losses from certain terminations) is amended by striking “personal property (as defined in section 1092(d)(1))” and inserting “property”.

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to terminations more than 30 days after the date of the enactment of this Act.

(b) TREATMENT OF SHORT SALES OF PROPERTY WHICH BECOMES SUBSTANTIALLY WORTHLESS.—

(1) IN GENERAL.—Section 1233 is amended by adding at the end the following new subsection:

“(h) SHORT SALES OF PROPERTY WHICH BECOMES SUBSTANTIALLY WORTHLESS.—

“(1) IN GENERAL.—If—

“(A) the taxpayer enters into a short sale of property, and

“(B) such property becomes substantially worthless,

the taxpayer shall recognize gain in the same manner as if the short sale were closed when the property becomes substantially worthless. To the extent provided in regulations prescribed by the Secretary, the preceding sentence also shall apply with respect to any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver any property, and any other similar transaction.

"(2) STATUTE OF LIMITATIONS.—If property becomes substantially worthless during a taxable year and any short sale of such property remains open at the time such property becomes substantially worthless, then—

"(A) the statutory period for the assessment of any deficiency attributable to any part of the gain on such transaction shall not expire before the earlier of—

"(i) the date which is 3 years after the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) of the substantial worthlessness of such property, or

"(ii) the date which is 6 years after the date the return for such taxable year is filed, and

"(B) such deficiency may be assessed before the date applicable under subparagraph (A) notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to property which becomes substantially worthless after the date of the enactment of this Act.

(c) APPLICATION OF CAPITAL TREATMENT, ETC. TO OBLIGATIONS ISSUED BY NATURAL PERSONS.—

(1) IN GENERAL.—Section 1271(b) is amended to read as follows:

"(b) EXCEPTION FOR CERTAIN OBLIGATIONS.—

"(1) IN GENERAL.—This section shall not apply to—

"(A) any obligation issued by a natural person before June 9, 1997, and

"(B) any obligation issued before July 2, 1982, by an issuer which is not a corporation and is not a government or political subdivision thereof.

"(2) TERMINATION.—Paragraph (1) shall not apply to any obligation purchased (within the meaning of section 1272(d)(1)) after June 8, 1997.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to sales, exchanges, and retirements after the date of enactment of this Act.

SEC. 1004. DETERMINATION OF ORIGINAL ISSUE DISCOUNT WHERE POOLED DEBT OBLIGATIONS SUBJECT TO ACCELERATION.

(a) IN GENERAL.—Subparagraph (C) of section 1272(a)(6) (relating to debt instruments to which the paragraph applies) is amended by striking "or" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", or", and by inserting after clause (ii) the following:

"(iii) any pool of debt instruments the yield on which may be affected by reason of prepayments (or to the extent provided in regulations, by reason of other events).

To the extent provided in regulations prescribed by the Secretary, in the case of a small business engaged in the trade or business of selling tangible personal property at retail, clause (iii) shall not apply to debt instruments incurred in the ordinary course of such trade or business while held by such business.".

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by this section to change its method of accounting for its first taxable year beginning after the date of the enactment of this Act—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account ratably over the 4-taxable year period beginning with such first taxable year.

SEC. 1005. DENIAL OF INTEREST DEDUCTIONS ON CERTAIN DEBT INSTRUMENTS.

(a) IN GENERAL.—Section 163 (relating to deduction for interest), as amended by title V, is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

"(l) DISALLOWANCE OF DEDUCTION ON CERTAIN DEBT INSTRUMENTS OF CORPORATIONS.—

"(1) IN GENERAL.—No deduction shall be allowed under this chapter for any interest paid or accrued on a disqualified debt instrument.

"(2) DISQUALIFIED DEBT INSTRUMENT.—For purposes of this subsection, the term 'disqualified debt instrument' means any indebtedness of a corporation which is payable in equity of the issuer or a related party.

"(3) SPECIAL RULES FOR AMOUNTS PAYABLE IN EQUITY.—For purposes of paragraph (2), indebtedness shall be treated as payable in equity of the issuer or a related party only if—

"(A) a substantial amount of the principal or interest is required to be paid or converted, or at the option of the issuer or a related party is payable in, or convertible into, such equity,

"(B) a substantial amount of the principal or interest is required to be determined, or at the option of the issuer or a related party is determined, by reference to the value of such equity, or

"(C) the indebtedness is part of an arrangement which is reasonably expected to result in a transaction described in subparagraph (A) or (B).

For purposes of this paragraph, principal or interest shall be treated as required to be so paid, converted, or determined if it may be required at the option of the holder or a related party and there is a substantial certainty the option will be exercised.

"(4) RELATED PARTY.—For purposes of this subsection, a person is a related party with respect to another person if such person bears a relationship to such other person described in section 267(b) or 707(b).

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, including regulations preventing avoidance of this subsection through the use of an issuer other than a corporation.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to disqualified debt instruments issued after June 8, 1997.

(2) TRANSITION RULE.—The amendment made by this section shall not apply to any instrument issued after June 8, 1997, if such instrument is—

(A) issued pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the issuance.

Subtitle B—Corporate Organizations and Reorganizations

SEC. 1011. TAX TREATMENT OF CERTAIN EXTRAORDINARY DIVIDENDS.

(a) TREATMENT OF EXTRAORDINARY DIVIDENDS IN EXCESS OF BASIS.—Paragraph (2) of section 1059(a) (relating to corporate shareholder's recognition of gain attributable to nontaxed portion of extraordinary dividends) is amended to read as follows:

"(2) AMOUNTS IN EXCESS OF BASIS.—If the nontaxed portion of such dividends exceeds such basis, such excess shall be treated as gain from the sale or exchange of such stock for the taxable year in which the extraordinary dividend is received.".

(b) TREATMENT OF REDEMPTIONS WHERE OPTIONS INVOLVED.—Paragraph (1) of section 1059(e) (relating to treatment of partial liquidations and non-pro rata redemptions) is amended to read as follows:

"(1) TREATMENT OF PARTIAL LIQUIDATIONS AND CERTAIN REDEMPTIONS.—Except as otherwise provided in regulations—

"(A) REDEMPTIONS.—In the case of any redemption of stock—

"(i) which is part of a partial liquidation (within the meaning of section 302(e)) of the redeeming corporation,

"(ii) which is not pro rata as to all shareholders, or

"(iii) which would not have been treated (in whole or in part) as a dividend if any options had not been taken into account under section 318(a)(4),

any amount treated as a dividend with respect to such redemption shall be treated as an extraordinary dividend to which paragraphs (1) and (2) of subsection (a) apply without regard to the period the taxpayer held such stock. In the case of a redemption described in clause (iii), only the basis in the stock redeemed shall be taken into account under subsection (a).

"(B) REORGANIZATIONS, ETC.—An exchange described in section 356 which is treated as a dividend shall be treated as a redemption of stock for purposes of applying subparagraph (A).".

(c) TIME FOR REDUCTION.—Paragraph (1) of section 1059(d) is amended to read as follows:

"(1) TIME FOR REDUCTION.—Any reduction in basis under subsection (a)(1) shall be treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend to which the reduction relates.".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to distributions after May 3, 1995.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution made pursuant to the terms of—

(A) a written binding contract in effect on May 3, 1995, and at all times thereafter before such distribution, or

(B) a tender offer outstanding on May 3, 1995.

(3) CERTAIN DIVIDENDS NOT PURSUANT TO CERTAIN REDEMPTIONS.—In determining whether the amendment made by subsection (a) applies to any extraordinary dividend other than a dividend treated as an extraordinary dividend under section 1059(e)(1) of the Internal Revenue Code of 1986 (as amended by this Act), paragraphs (1) and (2) shall be applied by substituting "September 13, 1995" for "May 3, 1995".

SEC. 1012. APPLICATION OF SECTION 355 TO DISTRIBUTIONS IN CONNECTION WITH ACQUISITIONS AND TO INTRAGROUP TRANSACTIONS.

(a) DISTRIBUTIONS IN CONNECTION WITH ACQUISITIONS.—Section 355 (relating to distributions of stock and securities of a controlled corporation) is amended by adding at the end the following new subsection:

"(e) RECOGNITION OF GAIN ON CERTAIN DISTRIBUTIONS OF STOCK OR SECURITIES IN CONNECTION WITH ACQUISITIONS.—

"(1) GENERAL RULE.—If there is a distribution to which this subsection applies, any stock or securities in the controlled corporation shall not be treated as qualified property for purposes of subsection (c)(2) of this section or section 361(c)(2).

“(2) DISTRIBUTIONS TO WHICH SUBSECTION APPLIES.—

“(A) IN GENERAL.—This subsection shall apply to any distribution—

“(i) to which this section (or so much of section 356 as relates to this section) applies, and

“(ii) which is part of a plan (or series of related transactions) pursuant to which 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

“(B) PLAN PRESUMED TO EXIST IN CERTAIN CASES.—If 1 or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation during the 4-year period beginning on the date which is 2 years before the date of the distribution, such acquisition shall be treated as pursuant to a plan described in subparagraph (A)(ii) unless it is established that the distribution and the acquisition are not pursuant to a plan or series of related transactions.

“(C) CERTAIN PLANS DISREGARDED.—A plan (or series of related transactions) shall not be treated as described in subparagraph (A)(ii) if, immediately after the completion of such plan or transactions, the distributing corporation and all controlled corporations are members of a single affiliated group (as defined in section 1504 without regard to subsection (b) thereof).

“(D) COORDINATION WITH SUBSECTION (d).—This subsection shall not apply to any distribution to which subsection (d) applies.

“(3) SPECIAL RULES RELATING TO ACQUISITIONS.—

“(A) CERTAIN ACQUISITIONS NOT TAKEN INTO ACCOUNT.—Except as provided in regulations, the following acquisitions shall not be treated as described in paragraph (2)(A)(ii):

“(i) The acquisition of stock in any controlled corporation by the distributing corporation.

“(ii) The acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation.

“(iii) The acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities in such distributing or controlled corporation.

“(iv) The acquisition of stock in a corporation if shareholders owning directly or indirectly stock possessing—

“(I) more than 50 percent of the total combined voting power of all classes of stock entitled to vote, and

“(II) more than 50 percent of the total value of shares of all classes of stock,

in the distributing corporation or any controlled corporation before such acquisition own directly or indi-

rectly stock possessing such vote and value in such distributing or controlled corporation after such acquisition.

This subparagraph shall not apply to any acquisition if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) described in paragraph (2)(A)(ii).

“(B) ASSET ACQUISITIONS.—Except as provided in regulations, for purposes of this subsection, if the assets of the distributing corporation or any controlled corporation are acquired by a successor corporation in a transaction described in subparagraph (A), (C), or (D) of section 368(a)(1) or any other transaction specified in regulations by the Secretary, the shareholders (immediately before the acquisition) of the corporation acquiring such assets shall be treated as acquiring stock in the corporation from which the assets were acquired.

“(4) DEFINITION AND SPECIAL RULES.—For purposes of this subsection—

“(A) 50-PERCENT OR GREATER INTEREST.—The term ‘50-percent or greater interest’ has the meaning given such term by subsection (d)(4).

“(B) DISTRIBUTIONS IN TITLE 11 OR SIMILAR CASE.—Paragraph (1) shall not apply to any distribution made in a title 11 or similar case (as defined in section 368(a)(3)).

“(C) AGGREGATION AND ATTRIBUTION RULES.—

“(i) AGGREGATION.—The rules of paragraph (7)(A) of subsection (d) shall apply.

“(ii) ATTRIBUTION.—Section 318(a)(2) shall apply in determining whether a person holds stock or securities in any corporation. Except as provided in regulations, section 318(a)(2)(C) shall be applied without regard to the phrase ‘50 percent or more in value’ for purposes of the preceding sentence.

“(D) SUCCESSORS AND PREDECESSORS.—For purposes of this subsection, any reference to a controlled corporation or a distributing corporation shall include a reference to any predecessor or successor of such corporation.

“(E) STATUTE OF LIMITATIONS.—If there is a distribution to which paragraph (1) applies—

“(i) the statutory period for the assessment of any deficiency attributable to any part of the gain recognized under this subsection by reason of such distribution shall not expire before the expiration of 3 years from the date the Secretary is notified by the taxpayer (in such manner as the Secretary may by regulations prescribe) that such distribution occurred, and

“(ii) such deficiency may be assessed before the expiration of such 3-year period notwithstanding the provisions of any other law or rule of law which would otherwise prevent such assessment.

“(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations—

"(A) providing for the application of this subsection where there is more than 1 controlled corporation,

"(B) treating 2 or more distributions as 1 distribution where necessary to prevent the avoidance of such purposes, and

"(C) providing for the application of rules similar to the rules of subsection (d)(6) where appropriate for purposes of paragraph (2)(B).".

(b) SPECIAL RULES FOR CERTAIN INTRAGROUP TRANSACTIONS.—

(1) SECTION 355 NOT TO APPLY.—Section 355, as amended by subsection (a), is amended by adding at the end the following new subsection:

"(f) SECTION NOT TO APPLY TO CERTAIN INTRAGROUP DISTRIBUTIONS.—Except as provided in regulations, this section (or so much of section 356 as relates to this section) shall not apply to the distribution of stock from 1 member of an affiliated group (as defined in section 1504(a)) to another member of such group if such distribution is part of a plan (or series of related transactions) described in subsection (e)(2)(A)(ii) (determined after the application of subsection (e)).".

(2) ADJUSTMENTS TO BASIS.—Section 358 (relating to basis to distributees) is amended by adding at the end the following new subsection:

"(g) ADJUSTMENTS IN INTRAGROUP TRANSACTIONS INVOLVING SECTION 355.—In the case of a distribution to which section 355 (or so much of section 356 as relates to section 355) applies and which involves the distribution of stock from 1 member of an affiliated group (as defined in section 1504(a) without regard to subsection (b) thereof) to another member of such group, the Secretary may, notwithstanding any other provision of this section, provide adjustments to the adjusted basis of any stock which—

"(1) is in a corporation which is a member of such group, and

"(2) is held by another member of such group,

to appropriately reflect the proper treatment of such distribution.".

(c) DETERMINATION OF CONTROL IN CERTAIN DIVISIVE TRANSACTIONS.—

(1) SECTION 351 TRANSACTIONS.—Section 351(c) (relating to special rule) is amended to read as follows:

"(c) SPECIAL RULES WHERE DISTRIBUTION TO SHAREHOLDERS.—In determining control for purposes of this section—

"(1) the fact that any corporate transferor distributes part or all of the stock in the corporation which it receives in the exchange to its shareholders shall not be taken into account, and

"(2) if the requirements of section 355 are met with respect to such distribution, the shareholders shall be treated as in control of such corporation immediately after the exchange if the shareholders own (immediately after the distribution) stock possessing—

"(A) more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

"(B) more than 50 percent of the total value of shares of all classes of stock of such corporation.".

(2) D REORGANIZATIONS.—Section 368(a)(2)(H) (relating to special rule for determining whether certain transactions are qualified under paragraph (1)(D)) is amended to read as follows:

"(H) SPECIAL RULES FOR DETERMINING WHETHER CERTAIN TRANSACTIONS ARE QUALIFIED UNDER PARAGRAPH (1)(D).—For purposes of determining whether a transaction qualifies under paragraph (1)(D)—

"(i) in the case of a transaction with respect to which the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met, the term 'control' has the meaning given such term by section 304(c), and

"(ii) in the case of a transaction with respect to which the requirements of section 355 are met, the shareholders described in paragraph (1)(D) shall be treated as having control of the corporation to which the assets are transferred if such shareholders own (immediately after the distribution) stock possessing—

"(I) more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

"(II) more than 50 percent of the total value of shares of all classes of stock of such corporation.".

(d) EFFECTIVE DATES.—

(1) SECTION 355 RULES.—The amendments made by subsections (a) and (b) shall apply to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 occurring after such date.

(2) DIVISIVE TRANSACTIONS.—The amendments made by subsection (c) shall apply to transfers after the date of the enactment of this Act.

(3) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a plan (or series of related transactions) which involves an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 (or, in the case of the amendments made by subsection (c), any transfer) occurring after April 16, 1997, if such acquisition or transfer is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the acquisition or transfer.

This paragraph shall not apply to any agreement, ruling request, or public announcement or filing unless it identifies the acquirer of the distributing corporation or any controlled corporation, or the transferee, whichever is applicable.

SEC. 1013. TAX TREATMENT OF REDEMPTIONS INVOLVING RELATED CORPORATIONS.

(a) STOCK PURCHASES BY RELATED CORPORATIONS.—The last sentence of section 304(a)(1) (relating to acquisition by related corporation other than subsidiary) is amended to read as follows: "To the extent that such distribution is treated as a distribution to which section 301 applies, the transferor and the acquiring corporation shall be treated in the same manner as if the transferor had transferred the stock so acquired to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and then the acquiring corporation had redeemed the stock it was treated as issuing in such transaction.".

(b) COORDINATION WITH SECTION 1059.—Clause (iii) of section 1059(e)(1)(A), as amended by this title, is amended to read as follows:

"(iii) which would not have been treated (in whole or in part) as a dividend if—

"(I) any options had not been taken into account under section 318(a)(4), or

"(II) section 304(a) had not applied,".

(c) SPECIAL RULE FOR ACQUISITIONS BY FOREIGN CORPORATIONS.—Section 304(b) (relating to special rules for application of subsection (a)) is amended by adding at the end the following new paragraph:

"(5) ACQUISITIONS BY FOREIGN CORPORATIONS.—

"(A) IN GENERAL.—In the case of any acquisition to which subsection (a) applies in which the acquiring corporation is a foreign corporation, the only earnings and profits taken into account under paragraph (2)(A) shall be those earnings and profits—

"(i) which are attributable (under regulations prescribed by the Secretary) to stock of the acquiring corporation owned (within the meaning of section 958(a)) by a corporation or individual which is—

"(I) a United States shareholder (within the meaning of section 951(b)) of the acquiring corporation, and

"(II) the transferor or a person who bears a relationship to the transferor described in section 267(b) or 707(b), and

"(ii) which were accumulated during the period or periods such stock was owned by such person while the acquiring corporation was a controlled foreign corporation.

"(B) APPLICATION OF SECTION 1248.—For purposes of subparagraph (A), the rules of section 1248(d) shall apply except to the extent otherwise provided by the Secretary.

"(C) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of this paragraph.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to distributions and acquisitions after June 8, 1997.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution or acquisition after June 8, 1997, if such distribution or acquisition is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

SEC. 1014. CERTAIN PREFERRED STOCK TREATED AS BOOT.

(a) SECTION 351.—Section 351 (relating to transfer to corporation controlled by transferor) is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:

"(g) NONQUALIFIED PREFERRED STOCK NOT TREATED AS STOCK.—

"(1) IN GENERAL.—In the case of a person who transfers property to a corporation and receives nonqualified preferred stock—

"(A) subsection (a) shall not apply to such transferor,

"(B) subsection (b) shall apply to such transferor, and

"(C) such nonqualified preferred stock shall be treated as other property for purposes of applying subsection (b).

"(2) NONQUALIFIED PREFERRED STOCK.—For purposes of paragraph (1)—

"(A) IN GENERAL.—The term 'nonqualified preferred stock' means preferred stock if—

"(i) the holder of such stock has the right to require the issuer or a related person to redeem or purchase the stock,

"(ii) the issuer or a related person is required to redeem or purchase such stock,

"(iii) the issuer or a related person has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or

"(iv) the dividend rate on such stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices.

"(B) LIMITATIONS.—Clauses (i), (ii), and (iii) of subparagraph (A) shall apply only if the right or obligation referred to therein may be exercised within the 20-year period beginning on the issue date of such stock and such right or obligation is not subject to a contingency which, as of the issue date, makes remote the likelihood of the redemption or purchase.

"(C) EXCEPTIONS FOR CERTAIN RIGHTS OR OBLIGATIONS.—

"(i) IN GENERAL.—A right or obligation shall not be treated as described in clause (i), (ii), or (iii) of subparagraph (A) if—

"(I) it may be exercised only upon the death, disability, or mental incompetency of the holder, or

"(II) in the case of a right or obligation to redeem or purchase stock transferred in connection with the performance of services for the issuer or a related person (and which represents reasonable compensation), it may be exercised only upon the holder's separation from service from the issuer or a related person.

"(ii) EXCEPTION.—Clause (i)(I) shall not apply if the stock relinquished in the exchange, or the stock acquired in the exchange is in—

"(I) a corporation if any class of stock in such corporation or a related party is readily tradable on an established securities market or otherwise, or

"(II) any other corporation if such exchange is part of a transaction or series of transactions in which such corporation is to become a corporation described in subclause (I).

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

"(A) PREFERRED STOCK.—The term 'preferred stock' means stock which is limited and preferred as to dividends and does not participate in corporate growth to any significant extent.

"(B) RELATED PERSON.—A person shall be treated as related to another person if they bear a relationship to such other person described in section 267(b) or 707(b).

"(4) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and sections 354(a)(2)(C), 355(a)(3)(D), and 356(e). The Secretary may also prescribe regulations, consistent with the treatment under this subsection and such sections, for the treatment of nonqualified preferred stock under other provisions of this title.".

(b) SECTION 354.—Paragraph (2) of section 354(a) (relating to exchanges of stock and securities in certain reorganizations) is amended by adding at the end the following new subparagraph:

"(C) NONQUALIFIED PREFERRED STOCK.—

"(i) IN GENERAL.—Nonqualified preferred stock (as defined in section 351(g)(2)) received in exchange for stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.

"(ii) RECAPITALIZATIONS OF FAMILY-OWNED CORPORATIONS.—

"(I) IN GENERAL.—Clause (i) shall not apply in the case of a recapitalization under section 368(a)(1)(E) of a family-owned corporation.

"(II) FAMILY-OWNED CORPORATION.—For purposes of this clause, except as provided in regulations, the term 'family-owned corporation' means any corporation which is described in clause (i) of section 447(d)(2)(C) throughout the 8-year period beginning on the date which is 5 years before the

date of the recapitalization. For purposes of the preceding sentence, stock shall not be treated as owned by a family member during any period described in section 355(d)(6)(B).".

(c) SECTION 355.—Paragraph (3) of section 355(a) is amended by adding at the end the following new subparagraph:

"(D) NONQUALIFIED PREFERRED STOCK.—Nonqualified preferred stock (as defined in section 351(g)(2)) received in a distribution with respect to stock other than nonqualified preferred stock (as so defined) shall not be treated as stock or securities.".

(d) SECTION 356.—Section 356 is amended by redesignating subsections (e) and (f) as subsections (f) and (g), respectively, and by inserting after subsection (d) the following new subsection:

"(e) NONQUALIFIED PREFERRED STOCK TREATED AS OTHER PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (2), the term 'other property' includes nonqualified preferred stock (as defined in section 351(g)(2)).

"(2) EXCEPTION.—The term 'other property' does not include nonqualified preferred stock (as so defined) to the extent that, under section 354 or 355, such preferred stock would be permitted to be received without the recognition of gain.".

(e) CONFORMING AMENDMENTS.—

(1) Subparagraph (B) of section 354(a)(2) and subparagraph (C) of section 355(a)(3)(C) are each amended by inserting "(including nonqualified preferred stock, as defined in section 351(g)(2))" after "stock".

(2) Subparagraph (A) of section 354(a)(3) and subparagraph (A) of section 355(a)(4) are each amended by inserting "nonqualified preferred stock and" after "including".

(3) Section 1036 is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) NONQUALIFIED PREFERRED STOCK NOT TREATED AS STOCK.—For purposes of this section, nonqualified preferred stock (as defined in section 351(g)(2)) shall be treated as property other than stock.".

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to transactions after June 8, 1997.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any transaction after June 8, 1997, if such transaction is—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

SEC. 1015. MODIFICATION OF HOLDING PERIOD APPLICABLE TO DIVIDENDS RECEIVED DEDUCTION.

(a) IN GENERAL.—Subparagraph (A) of section 246(c)(1) is amended to read as follows:

"(A) which is held by the taxpayer for 45 days or less during the 90-day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend, or".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 246(c) is amended to read as follows:

"(2) 90-DAY RULE IN THE CASE OF CERTAIN PREFERENCE DIVIDENDS.—In the case of stock having preference in dividends, if the taxpayer receives dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days, paragraph (1)(A) shall be applied—

"(A) by substituting '90 days' for '45 days' each place it appears, and

"(B) by substituting '180-day period' for '90-day period'.".

(2) Paragraph (3) of section 246(c) is amended by adding "and" at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to dividends received or accrued after the 30th day after the date of the enactment of this Act.

(2) TRANSITIONAL RULE.—The amendments made by this section shall not apply to dividends received or accrued during the 2-year period beginning on the date of the enactment of this Act if—

(A) the dividend is paid with respect to stock held by the taxpayer on June 8, 1997, and all times thereafter until the dividend is received,

(B) such stock is continuously subject to a position described in section 246(c)(4) of the Internal Revenue Code of 1986 on June 8, 1997, and all times thereafter until the dividend is received, and

(C) such stock and position are clearly identified in the taxpayer's records within 30 days after the date of the enactment of this Act.

Stock shall not be treated as meeting the requirement of subparagraph (B) if the position is sold, closed, or otherwise terminated and reestablished.

Subtitle C—Administrative Provisions

SEC. 1021. REPORTING OF CERTAIN PAYMENTS MADE TO ATTORNEYS.

(a) IN GENERAL.—Section 6045 (relating to returns of brokers) is amended by adding at the end the following new subsection:

"(f) RETURN REQUIRED IN THE CASE OF PAYMENTS TO ATTORNEYS.—

"(1) IN GENERAL.—Any person engaged in a trade or business and making a payment (in the course of such trade or business) to which this subsection applies shall file a return under subsection (a) and a statement under subsection (b) with respect to such payment.

"(2) APPLICATION OF SUBSECTION.—

"(A) IN GENERAL.—This subsection shall apply to any payment to an attorney in connection with legal services (whether or not such services are performed for the payor).

"(B) EXCEPTION.—This subsection shall not apply to the portion of any payment which is required to be reported under section 6041(a) (or would be so required but for the dollar limitation contained therein) or section 6051.".

(b) REPORTING OF ATTORNEYS' FEES PAYABLE TO CORPORATIONS.—The regulations providing an exception under section 6041 of the Internal Revenue Code of 1986 for payments made to corporations shall not apply to payments of attorneys' fees.

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

SEC. 1022. DECREASE OF THRESHOLD FOR REPORTING PAYMENTS TO CORPORATIONS PERFORMING SERVICES FOR FEDERAL AGENCIES.

(a) IN GENERAL.—Subsection (d) of section 6041A (relating to returns regarding payments of remuneration for services and direct sales) is amended by adding at the end the following new paragraph:

"(3) PAYMENTS TO CORPORATIONS BY FEDERAL EXECUTIVE AGENCIES.—

"(A) IN GENERAL.—Notwithstanding any regulation prescribed by the Secretary before the date of the enactment of this paragraph, subsection (a) shall apply to remuneration paid to a corporation by any Federal executive agency (as defined in section 6050M(b)).

"(B) EXCEPTION.—Subparagraph (A) shall not apply to—

"(i) services under contracts described in section 6050M(e)(3) with respect to which the requirements of section 6050M(e)(2) are met, and

"(ii) such other services as the Secretary may specify in regulations prescribed after the date of the enactment of this paragraph.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to returns the due date for which (determined without regard to any extension) is more than 90 days after the date of the enactment of this Act.

SEC. 1023. DISCLOSURE OF RETURN INFORMATION FOR ADMINISTRATION OF CERTAIN VETERANS PROGRAMS.

(a) GENERAL RULE.—Clause (viii) of section 6103(l)(7)(D) (relating to disclosure of return information to Federal, State, and local agencies administering certain programs) is amended by striking "1998" and inserting "2003".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 1024. CONTINUOUS LEVY ON CERTAIN PAYMENTS.

(a) IN GENERAL.—Section 6331 (relating to levy and distraint) is amended—

(1) by redesignating subsection (h) as subsection (i), and

(2) by inserting after subsection (g) the following new subsection:

"(h) CONTINUING LEVY ON CERTAIN PAYMENTS.—

"(1) IN GENERAL.—The effect of a levy on specified payments to or received by a taxpayer shall be continuous from the date such levy is first made until such levy is released. Notwithstanding section 6334, such continuous levy shall attach to up to 15 percent of any specified payment due to the taxpayer.

"(2) SPECIFIED PAYMENT.—For the purposes of paragraph (1), the term 'specified payment' means—

"(A) any Federal payment other than a payment for which eligibility is based on the income or assets (or both) of a payee,

"(B) any payment described in paragraph (4), (7), (9), or (11) of section 6334(a), and

"(C) any annuity or pension payment under the Railroad Retirement Act or benefit under the Railroad Unemployment Insurance Act.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to levies issued after the date of the enactment of this Act.

SEC. 1025. MODIFICATION OF LEVY EXEMPTION.

(a) IN GENERAL.—Section 6334 (relating to property exempt from levy) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) LEVY ALLOWED ON CERTAIN SPECIFIED PAYMENTS.—Any payment described in subparagraph (B) or (C) of section 6331(h)(2) shall not be exempt from levy if the Secretary approves the levy thereon under section 6331(h).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to levies issued after the date of the enactment of this Act.

SEC. 1026. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) IN GENERAL.—Subsection (k) of section 6103 is amended by adding at the end the following new paragraph:

"(8) LEVIES ON CERTAIN GOVERNMENT PAYMENTS.—

"(A) DISCLOSURE OF RETURN INFORMATION IN LEVIES ON FINANCIAL MANAGEMENT SERVICE.—In serving a notice of levy, or release of such levy, with respect to any applicable government payment, the Secretary may disclose to officers and employees of the Financial Management Service—

"(i) return information, including taxpayer identity information,

"(ii) the amount of any unpaid liability under this title (including penalties and interest), and

"(iii) the type of tax and tax period to which such unpaid liability relates.

"(B) RESTRICTION ON USE OF DISCLOSED INFORMATION.—Return information disclosed under subparagraph (A) may be used by officers and employees of the Financial Management Service only for the purpose of, and to the extent necessary in, transferring levied funds in satisfaction of the levy, maintaining appropriate agency records in regard to such levy or the release thereof, notifying the taxpayer and the agency certifying such payment that the levy has been honored, or in the defense of any litigation ensuing from the honor of such levy.

"(C) APPLICABLE GOVERNMENT PAYMENT.—For purposes of this paragraph, the term 'applicable government payment' means—

"(i) any Federal payment (other than a payment for which eligibility is based on the income or assets (or both) of a payee) certified to the Financial Management Service for disbursement, and

"(ii) any other payment which is certified to the Financial Management Service for disbursement and which the Secretary designates by published notice.".

(b) CONFORMING AMENDMENTS.—

(1) Section 6103(p) is amended—

(A) in paragraph (3)(A), by striking "(2), or (6)" and inserting "(2), (6), or (8)", and

(B) in paragraph (4), by inserting "(k)(8)," after "(j) (1) or (2)," each place it appears.

(2) Section 552a(a)(8)(B) of title 5, United States Code, is amended by striking "or" at the end of clause (v), by adding "or" at the end of clause (vi), and by adding at the end the following new clause:

"(vii) matches performed incident to a levy described in section 6103(k)(8) of the Internal Revenue Code of 1986;".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to levies issued after the date of the enactment of this Act.

SEC. 1027. RETURNS OF BENEFICIARIES OF ESTATES AND TRUSTS REQUIRED TO FILE RETURNS CONSISTENT WITH ESTATE OR TRUST RETURN OR TO NOTIFY SECRETARY OF INCONSISTENCY.

(a) DOMESTIC ESTATES AND TRUSTS.—Section 6034A (relating to information to beneficiaries of estates and trusts) is amended by adding at the end the following new subsection:

"(c) BENEFICIARY'S RETURN MUST BE CONSISTENT WITH ESTATE OR TRUST RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—

"(1) IN GENERAL.—A beneficiary of any estate or trust to which subsection (a) applies shall, on such beneficiary's return, treat any reported item in a manner which is consistent with the treatment of such item on the applicable entity's return.

"(2) NOTIFICATION OF INCONSISTENT TREATMENT.—

"(A) IN GENERAL.—In the case of any reported item, if—

"(i)(I) the applicable entity has filed a return but the beneficiary's treatment on such beneficiary's return

is (or may be) inconsistent with the treatment of the item on the applicable entity's return, or

"(II) the applicable entity has not filed a return, and

"(ii) the beneficiary files with the Secretary a statement identifying the inconsistency,

paragraph (1) shall not apply to such item.

"(B) BENEFICIARY RECEIVING INCORRECT INFORMATION.—A beneficiary shall be treated as having complied with clause (ii) of subparagraph (A) with respect to a reported item if the beneficiary—

"(i) demonstrates to the satisfaction of the Secretary that the treatment of the reported item on the beneficiary's return is consistent with the treatment of the item on the statement furnished under subsection (a) to the beneficiary by the applicable entity, and

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

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

"(A) described in subparagraph (A)(i)(I) of paragraph (2), and

"(B) in which the beneficiary does not comply with subparagraph (A)(ii) of paragraph (2),

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

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) REPORTED ITEM.—The term 'reported item' means any item for which information is required to be furnished under subsection (a).

"(B) APPLICABLE ENTITY.—The term 'applicable entity' means the estate or trust of which the taxpayer is the beneficiary.

"(5) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—For addition to tax in the case of a beneficiary's negligence in connection with, or disregard of, the requirements of this section, see part II of subchapter A of chapter 68.".

(b) FOREIGN TRUSTS.—Subsection (d) of section 6048 (relating to information with respect to certain foreign trusts) is amended by adding at the end the following new paragraph:

"(5) UNITED STATES PERSON'S RETURN MUST BE CONSISTENT WITH TRUST RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY.—Rules similar to the rules of section 6034A(c) shall apply to items reported by a trust under subsection (b)(1)(B) and to United States persons referred to in such subsection.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to returns of beneficiaries and owners filed after the date of the enactment of this Act.

SEC. 1028. REGISTRATION AND OTHER PROVISIONS RELATING TO CONFIDENTIAL CORPORATE TAX SHELTERS.

(a) IN GENERAL.—Section 6111 (relating to registration of tax shelters) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) CERTAIN CONFIDENTIAL ARRANGEMENTS TREATED AS TAX SHELTERS.—

"(1) IN GENERAL.—For purposes of this section, the term 'tax shelter' includes any entity, plan, arrangement, or transaction—

"(A) a significant purpose of the structure of which is the avoidance or evasion of Federal income tax for a direct or indirect participant which is a corporation,

"(B) which is offered to any potential participant under conditions of confidentiality, and

"(C) for which the tax shelter promoters may receive fees in excess of $100,000 in the aggregate.

"(2) CONDITIONS OF CONFIDENTIALITY.—For purposes of paragraph (1)(B), an offer is under conditions of confidentiality if—

"(A) the potential participant to whom the offer is made (or any other person acting on behalf of such participant) has an understanding or agreement with or for the benefit of any promoter of the tax shelter that such participant (or such other person) will limit disclosure of the tax shelter or any significant tax features of the tax shelter, or

"(B) any promoter of the tax shelter—

"(i) claims, knows, or has reason to know,

"(ii) knows or has reason to know that any other person (other than the potential participant) claims, or

"(iii) causes another person to claim,

that the tax shelter (or any aspect thereof) is proprietary to any person other than the potential participant or is otherwise protected from disclosure to or use by others.

For purposes of this subsection, the term 'promoter' means any person or any related person (within the meaning of section 267 or 707) who participates in the organization, management, or sale of the tax shelter.

"(3) PERSONS OTHER THAN PROMOTER REQUIRED TO REGISTER IN CERTAIN CASES.—

"(A) IN GENERAL.—If—

"(i) the requirements of subsection (a) are not met with respect to any tax shelter (as defined in paragraph (1)) by any tax shelter promoter, and

"(ii) no tax shelter promoter is a United States person,

then each United States person who discussed participation in such shelter shall register such shelter under subsection (a).

"(B) EXCEPTION.—Subparagraph (A) shall not apply to a United States person who discussed participation in a tax shelter if—

“(i) such person notified the promoter in writing (not later than the close of the 90th day after the day on which such discussions began) that such person would not participate in such shelter, and

“(ii) such person does not participate in such shelter.

“(4) OFFER TO PARTICIPATE TREATED AS OFFER FOR SALE.—For purposes of subsections (a) and (b), an offer to participate in a tax shelter (as defined in paragraph (1)) shall be treated as an offer for sale.”.

(b) PENALTY.—Subsection (a) of section 6707 (relating to failure to furnish information regarding tax shelters) is amended by adding at the end the following new paragraph:

“(3) CONFIDENTIAL ARRANGEMENTS.—

“(A) IN GENERAL.—In the case of a tax shelter (as defined in section 6111(d)), the penalty imposed under paragraph (1) shall be an amount equal to the greater of—

“(i) 50 percent of the fees paid to all promoters of the tax shelter with respect to offerings made before the date such shelter is registered under section 6111, or

“(ii) $10,000.

Clause (i) shall be applied by substituting ‘75 percent’ for ‘50 percent’ in the case of an intentional failure or act described in paragraph (1).

“(B) SPECIAL RULE FOR PARTICIPANTS REQUIRED TO REGISTER SHELTER.—In the case of a person required to register such a tax shelter by reason of section 6111(d)(3)—

“(i) such person shall be required to pay the penalty under paragraph (1) only if such person actually participated in such shelter,

“(ii) the amount of such penalty shall be determined by taking into account under subparagraph (A)(i) only the fees paid by such person, and

“(iii) such penalty shall be in addition to the penalty imposed on any other person for failing to register such shelter.”.

(c) MODIFICATIONS TO SUBSTANTIAL UNDERSTATEMENT PENALTY.—

(1) RESTRICTION ON REASONABLE BASIS FOR CORPORATE UNDERSTATEMENT OF INCOME TAX.—Subparagraph (B) of section 6662(d)(2) is amended by adding at the end the following new flush sentence:

“For purposes of clause (ii)(II), in no event shall a corporation be treated as having a reasonable basis for its tax treatment of an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.”.

(2) MODIFICATION TO DEFINITION OF TAX SHELTER.—Clause (iii) of section 6662(d)(2)(C) is amended by striking “the principal purpose” and inserting “a significant purpose”.

(d) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 6707(a) is amended by striking “The penalty” and inserting “Except as provided in paragraph (3), the penalty”.

(2) Subparagraph (A) of section 6707(a)(1) is amended by striking "paragraph (2)" and inserting "paragraph (2) or (3), as the case may be".

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to any tax shelter (as defined in section 6111(d) of the Internal Revenue Code of 1986, as amended by this section) interests in which are offered to potential participants after the Secretary of the Treasury prescribes guidance with respect to meeting requirements added by such amendments.

(2) MODIFICATIONS TO SUBSTANTIAL UNDERSTATEMENT PENALTY.—The amendments made by subsection (c) shall apply to items with respect to transactions entered into after the date of the enactment of this Act.

Subtitle D—Excise and Employment Tax Provisions

SEC. 1031. EXTENSION AND MODIFICATION OF TAXES FUNDING AIRPORT AND AIRWAY TRUST FUND; INCREASED DEPOSITS INTO SUCH FUND.

(a) FUEL TAXES.—

(1) AVIATION FUEL.—Clause (ii) of section 4091(b)(3)(A) is amended by striking "September 30, 1997" and inserting "September 30, 2007".

(2) AVIATION GASOLINE.—Subparagraph (B) of section 4081(d)(2) is amended by striking "September 30, 1997" and inserting "September 30, 2007".

(3) NONCOMMERCIAL AVIATION.—Subparagraph (B) of section 4041(c)(3) is amended by striking "September 30, 1997" and inserting "September 30, 2007".

(b) TICKET TAXES.—

(1) PERSONS.—Clause (ii) of section 4261(g)(1)(A) is amended by striking "September 30, 1997" and inserting "September 30, 2007".

(2) PROPERTY.—Clause (ii) of section 4271(d)(1)(A) is amended by striking "September 30, 1997" and inserting "September 30, 2007".

(c) MODIFICATIONS TO TAX ON TRANSPORTATION OF PERSONS BY AIR.—

(1) IN GENERAL.—Section 4261 (relating to imposition of tax) is amended by striking subsections (a), (b), and (c) and inserting the following new subsections:

"(a) IN GENERAL.—There is hereby imposed on the amount paid for taxable transportation of any person a tax equal to 7.5 percent of the amount so paid.

"(b) DOMESTIC SEGMENTS OF TAXABLE TRANSPORTATION.—

"(1) IN GENERAL.—There is hereby imposed on the amount paid for each domestic segment of taxable transportation by air a tax in the amount determined in accordance with the following table for the period in which the segment begins:

In the case of segments beginning:	*The tax is:*
After September 30, 1997, and before October 1, 1998	*$1.00*
After September 30, 1998, and before October 1, 1999	*$2.00*
After September 30, 1999, and before January 1, 2000	*$2.25*
During 2000	*$2.50*
During 2001	*$2.75*
During 2002 or thereafter	*$3.00.*

"(2) DOMESTIC SEGMENT.—For purposes of this section, the term 'domestic segment' means any segment consisting of 1 takeoff and 1 landing and which is taxable transportation described in section 4262(a)(1).

"(3) CHANGES IN SEGMENTS BY REASON OF REROUTING.—If—

"(A) transportation is purchased between 2 locations on specified flights, and

"(B) there is a change in the route taken between such 2 locations which changes the number of domestic segments, but there is no change in the amount charged for such transportation,

the tax imposed by paragraph (1) shall be determined without regard to such change in route.

"(c) USE OF INTERNATIONAL TRAVEL FACILITIES.—

"(1) IN GENERAL.—There is hereby imposed a tax of $12.00 on any amount paid (whether within or without the United States) for any transportation of any person by air, if such transportation begins or ends in the United States.

"(2) EXCEPTION FOR TRANSPORTATION ENTIRELY TAXABLE UNDER SUBSECTION (a).—This subsection shall not apply to any transportation all of which is taxable under subsection (a) (determined without regard to sections 4281 and 4282).

"(3) SPECIAL RULE FOR ALASKA AND HAWAII.—In any case in which the tax imposed by paragraph (1) applies to a domestic segment beginning or ending in Alaska or Hawaii, such tax shall apply only to departures and shall be at the rate of $6.".

(2) SPECIAL RULES.—Section 4261 is amended by redesignating subsections (e), (f), and (g) as subsections (f), (g), and (h), respectively, and by inserting after subsection (d) the following new subsection:

"(e) SPECIAL RULES.—

"(1) SEGMENTS TO AND FROM RURAL AIRPORTS.—

"(A) EXCEPTION FROM SEGMENT TAX.—The tax imposed by subsection (b)(1) shall not apply to any domestic segment beginning or ending at an airport which is a rural airport for the calendar year in which such segment begins or ends (as the case may be).

"(B) RURAL AIRPORT.—For purposes of this paragraph, the term 'rural airport' means, with respect to any calendar year, any airport if—

"(i) there were fewer than 100,000 commercial passengers departing by air during the second preceding calendar year from such airport, and

"(ii) such airport—

"(I) is not located within 75 miles of another airport which is not described in clause (i), or

"(II) is receiving essential air service subsidies as of the date of the enactment of this paragraph.

"(C) NO PHASEIN OF REDUCED TICKET TAX.—In the case of transportation beginning before October 1, 1999—

"(i) IN GENERAL.—Paragraph (5) shall not apply to any domestic segment beginning or ending at an airport which is a rural airport for the calendar year in which such segment begins or ends (as the case may be).

"(ii) TRANSPORTATION INVOLVING MULTIPLE SEGMENTS.—In the case of transportation involving more than 1 domestic segment at least 1 of which does not begin or end at a rural airport, the 7.5 percent rate applicable by reason of clause (i) shall be applied by taking into account only an amount which bears the same ratio to the amount paid for such transportation as the number of specified miles in domestic segments which begin or end at a rural airport bears to the total number of specified miles in such transportation.

"(2) AMOUNTS PAID OUTSIDE THE UNITED STATES.—In the case of amounts paid outside the United States for taxable transportation, the taxes imposed by subsections (a) and (b) shall apply only if such transportation begins and ends in the United States.

"(3) AMOUNTS PAID FOR RIGHT TO AWARD FREE OR REDUCED RATE AIR TRANSPORTATION.—

"(A) IN GENERAL.—Any amount paid (and the value of any other benefit provided) to an air carrier (or any related person) for the right to provide mileage awards for (or other reductions in the cost of) any transportation of persons by air shall be treated for purposes of subsection (a) as an amount paid for taxable transportation, and such amount shall be taxable under subsection (a) without regard to any other provision of this subchapter.

"(B) CONTROLLED GROUP.—For purposes of subparagraph (A), a corporation and all wholly owned subsidiaries of such corporation shall be treated as 1 corporation.

"(C) REGULATIONS.—The Secretary shall prescribe rules which reallocate items of income, deduction, credit, exclusion, or other allowance to the extent necessary to prevent the avoidance of tax imposed by reason of this paragraph. The Secretary may prescribe rules which exclude from the tax imposed by subsection (a) amounts attributable to mileage awards which are used other than for transportation of persons by air.

"(4) INFLATION ADJUSTMENT OF DOLLAR RATES OF TAX.—

"(A) IN GENERAL.—In the case of taxable events in a calendar year after the last nonindexed year, the $3.00 amount contained in subsection (b) and each dollar amount contained in subsection (c) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by sub-

stituting the year before the last nonindexed year for 'calendar year 1992' in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of 10 cents, such increase shall be rounded to the nearest multiple of 10 cents.

"(B) LAST NONINDEXED YEAR.—For purposes of subparagraph (A), the last nonindexed year is—

"(i) 2002 in the case of the $3.00 amount contained in subsection (b), and

"(ii) 1998 in the case of the dollar amounts contained in subsection (c).

"(C) TAXABLE EVENT.—For purposes of subparagraph (A), in the case of the tax imposed subsection (b), the beginning of the domestic segment shall be treated as the taxable event.

"(5) RATES OF TICKET TAX FOR TRANSPORTATION BEGINNING BEFORE OCTOBER 1, 1999.—Subsection (a) shall be applied by substituting for '7.5 percent'—

"(A) '9 percent' in the case of transportation beginning after September 30, 1997, and before October 1, 1998, and

"(B) '8 percent' in the case of transportation beginning after September 30, 1998, and before October 1, 1999.".

(3) SECONDARY LIABILITY OF CARRIER FOR UNPAID TAX.—Subsection (c) of section 4263 is amended by striking "subchapter—" and all that follows and inserting "subchapter, such tax shall be paid by the carrier providing the initial segment of such transportation which begins or ends in the United States.".

(d) INCREASED AIRPORT AND AIRWAY TRUST FUND DEPOSITS.—

(1) Paragraph (1) of section 9502(b) is amended—

(A) by striking "(to the extent that the rate of the tax on such gasoline exceeds 4.3 cents per gallon)" in subparagraph (C),

(B) by striking "to the extent attributable to the Airport and Airway Trust Fund financing rate" in subparagraph (D), and

(C) by adding at the end the following flush sentence: "There shall not be taken into account under paragraph (1) so much of the taxes imposed by sections 4081 and 4091 as are determined at the rates specified in section 4081(a)(2)(B) or 4091(b)(2).".

(2) Section 9502 is amended by striking subsection (f).

(e) EFFECTIVE DATES.—

(1) FUEL TAXES.—The amendments made by subsection (a) shall apply take effect on October 1, 1997.

(2) TICKET TAXES.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendments made by subsections (b) and (c) shall apply to transportation beginning on or after October 1, 1997.

(B) TREATMENT OF AMOUNTS PAID FOR TICKETS PURCHASED BEFORE DATE OF ENACTMENT.—The amendments made by subsection (c) shall not apply to amounts paid for a ticket purchased before the date of the enactment of this

Act for a specified flight beginning on or after October 1, 1997.

(C) AMOUNTS PAID FOR RIGHT TO AWARD MILEAGE AWARDS.—

(i) IN GENERAL.—Paragraph (3) of section 4261(e) of the Internal Revenue Code of 1986 (as added by the amendment made by subsection (c)) shall apply to amounts paid (and other benefits provided) after September 30, 1997.

(ii) PAYMENTS WITHIN CONTROLLED GROUP.—For purposes of clause (i), any amount paid after June 11, 1997, and before October 1, 1997, by 1 member of a controlled group for a right which is described in such section 4261(e)(3) and is furnished by another member of such group after September 30, 1997, shall be treated as paid after September 30, 1997. For purposes of the preceding sentence, all persons treated as a single employer under subsection (a) or (b) of section 52 of such Code shall be treated as members of a controlled group.

(3) INCREASED DEPOSITS INTO AIRPORT AND AIRWAY TRUST FUND.—The amendments made by subsection (d) shall apply with respect to taxes received in the Treasury on and after October 1, 1997.

(g) DELAYED DEPOSITS OF AIRPORT TRUST FUND TAX REVENUES.—Notwithstanding section 6302 of the Internal Revenue Code of 1986—

(1) in the case of deposits of taxes imposed by section 4261 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after August 14, 1997, and before October 1, 1997, shall be October 10, 1997,

(2) in the case of deposits of taxes imposed by section 4261 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after August 14, 1998, and before October 1, 1998, shall be October 5, 1998, and

(3) in the case of deposits of taxes imposed by sections 4081(a)(2)(A)(ii), 4091, and 4271 of such Code, the due date for any such deposit which would (but for this subsection) be required to be made after July 31, 1998, and before October 1, 1998, shall be October 5, 1998.

SEC. 1032. KEROSENE TAXED AS DIESEL FUEL.

(a) IN GENERAL.—Subsection (a) of section 4083 (defining taxable fuel) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) kerosene.".

(b) RATE OF TAX.—Clause (iii) of section 4081(a)(2)(A) is amended by inserting "or kerosene" after "diesel fuel".

(c) EXEMPTIONS FROM TAX; REFUNDS TO VENDORS.—

(1) IN GENERAL.—Section 4082 (relating to exemptions for diesel fuel) is amended by striking "diesel fuel" each place it appears in subsections (a), (c), and (d) and inserting "diesel fuel and kerosene".

(2) CERTAIN KEROSENE EXEMPT FROM DYEING REQUIREMENT.—Section 4082 is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) ADDITIONAL EXCEPTIONS TO DYEING REQUIREMENTS FOR KEROSENE.—

"(1) AVIATION-GRADE KEROSENE.—Subsection (a)(2) shall not apply to a removal, entry, or sale of aviation-grade kerosene (as determined under regulations prescribed by the Secretary) if the person receiving the kerosene is registered under section 4101 with respect to the tax imposed by section 4091.

"(2) USE FOR NON-FUEL FEEDSTOCK PURPOSES.—Subsection (a)(2) shall not apply to kerosene—

"(A) received by pipeline or vessel for use by the person receiving the kerosene in the manufacture or production of any substance (other than gasoline, diesel fuel, or special fuels referred to in section 4041), or

"(B) to the extent provided in regulations, removed or entered—

"(i) for such a use by the person removing or entering the kerosene, or

"(ii) for resale by such person for such a use by the purchaser,

but only if the person receiving, removing, or entering the kerosene and such purchaser (if any) are registered under section 4101 with respect to the tax imposed by section 4081.

"(3) WHOLESALE DISTRIBUTORS.—To the extent provided in regulations, subsection (a)(2) shall not apply to a removal, entry, or sale of kerosene to a wholesale distributor of kerosene if such distributor—

"(A) is registered under section 4101 with respect to the tax imposed by section 4081 on kerosene, and

"(B) sells kerosene exclusively to ultimate vendors described in section 6427(l)(5)(B) with respect to kerosene."

(3) REFUNDS.—

(A) Subsection (l) of section 6427 is amended by inserting "or kerosene" after "diesel fuel" each place it appears in paragraphs (1), (2), and (5) (including the heading for paragraph (5)).

(B) Paragraph (5) of section 6427(l) is amended by redesignating subparagraph (B) as subparagraph (C) and by inserting after subparagraph (A) the following new subparagraph:

"(B) SALES OF KEROSENE NOT FOR USE IN MOTOR FUEL.—Paragraph (1)(A) shall not apply to kerosene sold by a vendor—

"(i) for any use if such sale is from a pump which (as determined under regulations prescribed by the Secretary) is not suitable for use in fueling any diesel-powered highway vehicle or train, or

"(ii) to the extent provided by the Secretary, for blending with heating oil to be used during periods of extreme or unseasonable cold.".

(C) Subparagraph (C) of section 6427(l)(5), as redesignated by subparagraph (B) of this paragraph, is amended by striking "subparagraph (A)" and inserting "subparagraph (A) or (B)".

(D) The heading for subsection (l) of section 6427 is amended by inserting ", KEROSENE," after "DIESEL FUEL".

(E) Clause (i) of section 6427(i)(5)(A) is amended by inserting "($100 or more in the case of kerosene)" after "$200 or more".

(d) CERTAIN APPROVED TERMINALS OF REGISTERED PERSONS REQUIRED TO OFFER DYED DIESEL FUEL AND KEROSENE FOR NONTAXABLE PURPOSES.—Section 4101 is amended by adding at the end the following new subsection:

"(e) CERTAIN APPROVED TERMINALS OF REGISTERED PERSONS REQUIRED TO OFFER DYED DIESEL FUEL AND KEROSENE FOR NONTAXABLE PURPOSES.—

"(1) IN GENERAL.—A terminal for kerosene or diesel fuel may not be an approved facility for storage of non-tax-paid diesel fuel or kerosene under this section unless the operator of such terminal offers dyed diesel fuel and kerosene for removal for nontaxable use in accordance with section 4082(a).

"(2) EXCEPTION.—Paragraph (1) shall not apply to any terminal exclusively providing aviation-grade kerosene by pipeline to an airport.".

(e) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 4041(a), as amended by title IX, is amended by striking "kerosene,".

(2) Paragraph (1) of section 4041(c) is amended by striking "any liquid" and inserting "kerosene and any other liquid".

*(3)(A) The heading for section 4082 is amended by inserting "**AND KEROSENE**" after "**DIESEL FUEL**".*

(B) The table of sections for subpart A of part III of subchapter A of chapter 32 is amended by inserting "and kerosene" after "diesel fuel" in the item relating to section 4082.

(4) Subsection (b) of section 4083 is amended by striking "gasoline, diesel fuel," and inserting "taxable fuels".

(5) Subsection (a) of section 4093 is amended by striking "any liquid" and inserting "kerosene and any other liquid".

(6) The material following subparagraph (F) of section 6416(b)(2) is amended by inserting "or kerosene" after "diesel fuel".

(7) Paragraphs (1) and (3) of section 6427(f), and the heading for section 6427(f), are each amended by inserting "kerosene," after "diesel fuel,".

(8) Paragraph (2) of section 6427(f) is amended by striking "or diesel fuel" each place it appears and inserting ", diesel fuel, or kerosene".

(9) Subparagraph (A) of section 6427(i)(3) is amended by striking "or diesel fuel" and inserting ", diesel fuel, or kerosene".

(10) The heading for paragraph (4) of section 6427(i) is amended to read as follows:

"(4) SPECIAL RULE FOR REFUNDS UNDER SUBSECTION (l).—"

(11) Paragraph (1) of section 6715(c) is amended by inserting "or kerosene" after "diesel fuel".

(12)(A) The text of section 7232 is amended by striking "gasoline, lubricating oil, diesel fuel" and inserting "any taxable fuel (as defined in section 4083)".

(B) The section heading for section 7232 is amended to read as follows:

"SEC. 7232. FAILURE TO REGISTER UNDER SECTION 4101, FALSE REPRESENTATIONS OF REGISTRATION STATUS, ETC.".

(C) The table of sections for part II of subchapter A of chapter 75 is amended by striking the item relating to section 7232 and inserting the following:

"Sec. 7232. Failure to register under section 4101, false representations of registration status, etc.".

(13) Sections 9503(b)(1)(E) and 9508(b)(2) are each amended by striking "and diesel fuel" and inserting ", diesel fuel, and kerosene".

(14) Subparagraph (B) of section 9503(b)(5) is amended by striking "or diesel fuel" and inserting ", diesel fuel, or kerosene".

(f) EFFECTIVE DATE.—The amendments made by this section shall take effect on July 1, 1998.

(g) FLOOR STOCK TAXES.—

(1) IMPOSITION OF TAX.—In the case of kerosene which is held on July 1, 1998, by any person, there is hereby imposed a floor stocks tax of 24.4 cents per gallon.

(2) LIABILITY FOR TAX AND METHOD OF PAYMENT.—

(A) LIABILITY FOR TAX.—A person holding kerosene on July 1, 1998, to which the tax imposed by paragraph (1) applies shall be liable for such tax.

(B) METHOD OF PAYMENT.—The tax imposed by paragraph (1) shall be paid in such manner as the Secretary shall prescribe.

(C) TIME FOR PAYMENT.—The tax imposed by paragraph (1) shall be paid on or before August 31, 1998.

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

(A) HELD BY A PERSON.—Kerosene shall be considered as "held by a person" if title thereto has passed to such person (whether or not delivery to the person has been made).

(B) SECRETARY.—The term "Secretary" means the Secretary of the Treasury or his delegate.

(4) EXCEPTION FOR EXEMPT USES.—The tax imposed by paragraph (1) shall not apply to kerosene held by any person exclusively for any use to the extent a credit or refund of the tax imposed by section 4081 of the Internal Revenue Code of 1986 is allowable for such use.

(5) EXCEPTION FOR FUEL HELD IN VEHICLE TANK.—No tax shall be imposed by paragraph (1) on kerosene held in the tank of a motor vehicle or motorboat.

(6) EXCEPTION FOR CERTAIN AMOUNTS OF FUEL.—

(A) IN GENERAL.—No tax shall be imposed by paragraph (1) on kerosene held on July 1, 1998, by any person if the aggregate amount of kerosene held by such person on such date does not exceed 2,000 gallons. The preceding sen-

tence shall apply only if such person submits to the Secretary (at the time and in the manner required by the Secretary) such information as the Secretary shall require for purposes of this paragraph.

(B) EXEMPT FUEL.—For purposes of subparagraph (A), there shall not be taken into account fuel held by any person which is exempt from the tax imposed by paragraph (1) by reason of paragraph (4) or (5).

(C) CONTROLLED GROUPS.—For purposes of this paragraph—

(i) CORPORATIONS.—

(I) IN GENERAL.—All persons treated as a controlled group shall be treated as 1 person.

(II) CONTROLLED GROUP.—The term "controlled group" has the meaning given to such term by subsection (a) of section 1563 of such Code; except that for such purposes the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in such subsection.

(ii) NONINCORPORATED PERSONS UNDER COMMON CONTROL.—Under regulations prescribed by the Secretary, principles similar to the principles of clause (i) shall apply to a group of persons under common control where 1 or more of such persons is not a corporation.

(7) COORDINATION WITH SECTION 4081.—No tax shall be imposed by paragraph (1) on kerosene to the extent that tax has been (or will be) imposed on such kerosene under section 4081 or 4091 of such Code.

(8) OTHER LAWS APPLICABLE.—All provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081 of such Code shall, insofar as applicable and not inconsistent with the provisions of this subsection, apply with respect to the floor stock taxes imposed by paragraph (1) to the same extent as if such taxes were imposed by such section 4081.

SEC. 1033. RESTORATION OF LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAXES.

Paragraph (3) of section 4081(d) is amended by striking "shall not apply after December 31, 1995" and inserting "shall apply after September 30, 1997, and before April 1, 2005".

SEC. 1034. APPLICATION OF COMMUNICATIONS TAX TO PREPAID TELEPHONE CARDS.

(a) IN GENERAL.—Section 4251 is amended by adding at the end the following new subsection:

"(d) TREATMENT OF PREPAID TELEPHONE CARDS.—

"(1) IN GENERAL.—For purposes of this subchapter, in the case of communications services acquired by means of a prepaid telephone card—

"(A) the face amount of such card shall be treated as the amount paid for such communications services, and

"(B) that amount shall be treated as paid when the card is transferred by any telecommunications carrier to any person who is not such a carrier.

"(2) DETERMINATION OF FACE AMOUNT IN ABSENCE OF SPECIFIED DOLLAR AMOUNT.—In the case of any prepaid telephone card which entitles the user other than to a specified dollar amount of use, the face amount shall be determined under regulations prescribed by the Secretary.

"(3) PREPAID TELEPHONE CARD.—For purposes of this subsection, the term 'prepaid telephone card' means any card or other similar arrangement which permits its holder to obtain communications services and pay for such services in advance.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid in calendar months beginning more than 60 days after the date of the enactment of this Act.

SEC. 1035. EXTENSION OF TEMPORARY UNEMPLOYMENT TAX.

Section 3301 (relating to rate of unemployment tax) is amended—

(1) by striking "1998" in paragraph (1) and inserting "2007", and

(2) by striking "1999" in paragraph (2) and inserting "2008".

Subtitle E—Provisions Relating to Tax-Exempt Entities

SEC. 1041. EXPANSION OF LOOK-THRU RULE FOR INTEREST, ANNUITIES, ROYALTIES, AND RENTS DERIVED BY SUBSIDIARIES OF TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Paragraph (13) of section 512(b) is amended to read as follows:

"(13) SPECIAL RULES FOR CERTAIN AMOUNTS RECEIVED FROM CONTROLLED ENTITIES.—

"(A) IN GENERAL.—If an organization (in this paragraph referred to as the 'controlling organization') receives (directly or indirectly) a specified payment from another entity which it controls (in this paragraph referred to as the 'controlled entity'), notwithstanding paragraphs (1), (2), and (3), the controlling organization shall include such payment as an item of gross income derived from an unrelated trade or business to the extent such payment reduces the net unrelated income of the controlled entity (or increases any net unrelated loss of the controlled entity). There shall be allowed all deductions of the controlling organization directly connected with amounts treated as derived from an unrelated trade or business under the preceding sentence.

"(B) NET UNRELATED INCOME OR LOSS.—For purposes of this paragraph—

"(i) NET UNRELATED INCOME.—The term 'net unrelated income' means—

"(I) in the case of a controlled entity which is not exempt from tax under section 501(a), the por-

tion of such entity's taxable income which would be unrelated business taxable income if such entity were exempt from tax under section 501(a) and had the same exempt purposes (as defined in section 513A(a)(5)(A)) as the controlling organization, or

"(II) in the case of a controlled entity which is exempt from tax under section 501(a), the amount of the unrelated business taxable income of the controlled entity.

"(ii) NET UNRELATED LOSS.—The term 'net unrelated loss' means the net operating loss adjusted under rules similar to the rules of clause (i).

"(C) SPECIFIED PAYMENT.—For purposes of this paragraph, the term 'specified payment' means any interest, annuity, royalty, or rent.

"(D) DEFINITION OF CONTROL.—For purposes of this paragraph—

"(i) CONTROL.—The term 'control' means—

"(I) in the case of a corporation, ownership (by vote or value) of more than 50 percent of the stock in such corporation,

"(II) in the case of a partnership, ownership of more than 50 percent of the profits interests or capital interests in such partnership, or

"(III) in any other case, ownership of more than 50 percent of the beneficial interests in the entity.

"(ii) CONSTRUCTIVE OWNERSHIP.—Section 318 (relating to constructive ownership of stock) shall apply for purposes of determining ownership of stock in a corporation. Similar principles shall apply for purposes of determining ownership of interests in any other entity.

"(E) RELATED PERSONS.—The Secretary shall prescribe such rules as may be necessary or appropriate to prevent avoidance of the purposes of this paragraph through the use of related persons.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any payment made during the first 2 taxable years beginning on or after the date of the enactment of this Act if such payment is made pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such payment.

SEC. 1042. TERMINATION OF CERTAIN EXCEPTIONS FROM RULES RELATING TO EXEMPT ORGANIZATIONS WHICH PROVIDE COMMERCIAL-TYPE INSURANCE.

(a) IN GENERAL.—Subparagraphs (A) and (B) of section 1012(c)(4) of the Tax Reform Act of 1986 shall not apply to any taxable year beginning after December 31, 1997.

(b) SPECIAL RULES.—In the case of an organization to which section 501(m) of the Internal Revenue Code of 1986 applies solely by reason of the amendment made by subsection (a)—

(1) no adjustment shall be made under section 481 (or any other provision) of such Code on account of a change in its method of accounting for its first taxable year beginning after December 31, 1997, and

(2) for purposes of determining gain or loss, the adjusted basis of any asset held on the 1st day of such taxable year shall be treated as equal to its fair market value as of such day.

(c) RESERVE WEAKENING AFTER JUNE 8, 1997.—Any reserve weakening after June 8, 1997, by an organization described in subsection (b) shall be treated as occurring in such organization's 1st taxable year beginning after December 31, 1997.

(d) REGULATIONS.—The Secretary of the Treasury or his delegate may prescribe rules for providing proper adjustments for organizations described in subsection (b) with respect to short taxable years which begin during 1998 by reason of section 843 of the Internal Revenue Code of 1986.

Subtitle F—Foreign Provisions

SEC. 1051. DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY INCOME.

(a) INCOME FROM NOTIONAL PRINCIPAL CONTRACTS AND PAYMENTS IN LIEU OF DIVIDENDS.—

(1) IN GENERAL.—Paragraph (1) of section 954(c) (defining foreign personal holding company income) is amended by adding at the end the following new subparagraphs:

"(F) INCOME FROM NOTIONAL PRINCIPAL CONTRACTS.—Net income from notional principal contracts. Any item of income, gain, deduction, or loss from a notional principal contract entered into for purposes of hedging any item described in any preceding subparagraph shall not be taken into account for purposes of this subparagraph but shall be taken into account under such other subparagraph.

"(G) PAYMENTS IN LIEU OF DIVIDENDS.—Payments in lieu of dividends which are made pursuant to an agreement to which section 1058 applies.".

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 954(c)(1) is amended—

(A) by striking the second sentence, and

(B) by striking "also" in the last sentence.

(b) EXCEPTION FOR DEALERS.—Paragraph (2) of section 954(c) is amended by adding at the end the following new subparagraph:

"(C) EXCEPTION FOR DEALERS.—Except as provided in subparagraph (A), (E), or (G) of paragraph (1) or by regulations, in the case of a regular dealer in property (within the meaning of paragraph (1)(B)), forward contracts, option contracts, or similar financial instruments (including notional principal contracts and all instruments referenced to commodities), there shall not be taken into account in computing foreign personal holding income any item of income, gain, deduction, or loss from any transaction (including

hedging transactions) entered into in the ordinary course of such dealer's trade or business as such a dealer.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1052. PERSONAL PROPERTY USED PREDOMINANTLY IN THE UNITED STATES TREATED AS NOT PROPERTY OF A LIKE KIND WITH RESPECT TO PROPERTY USED PREDOMINANTLY OUTSIDE THE UNITED STATES.

(a) IN GENERAL.—Subsection (h) of section 1031 (relating to exchange of property held for productive use or investment) is amended to read as follows:

"(h) SPECIAL RULES FOR FOREIGN REAL AND PERSONAL PROPERTY.—For purposes of this section—

"(1) REAL PROPERTY.—Real property located in the United States and real property located outside the United States are not property of a like kind.

"(2) PERSONAL PROPERTY.—

"(A) IN GENERAL.—Personal property used predominantly within the United States and personal property used predominantly outside the United States are not property of a like kind.

"(B) PREDOMINANT USE.—Except as provided in subparagraph (C) and (D), the predominant use of any property shall be determined based on—

"(i) in the case of the property relinquished in the exchange, the 2-year period ending on the date of such relinquishment, and

"(ii) in the case of the property acquired in the exchange, the 2-year period beginning on the date of such acquisition.

"(C) PROPERTY HELD FOR LESS THAN 2 YEARS.—Except in the case of an exchange which is part of a transaction (or series of transactions) structured to avoid the purposes of this subsection—

"(i) only the periods the property was held by the person relinquishing the property (or any related person) shall be taken into account under subparagraph (B)(i), and

"(ii) only the periods the property was held by the person acquiring the property (or any related person) shall be taken into account under subparagraph (B)(ii).

"(D) SPECIAL RULE FOR CERTAIN PROPERTY.—Property described in any subparagraph of section 168(g)(4) shall be treated as used predominantly in the United States.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to transfers after June 8, 1997, in taxable years ending after such date.

(2) BINDING CONTRACTS.—The amendment made by this section shall not apply to any transfer pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before the disposition of property. A contract shall not

fail to meet the requirements of the preceding sentence solely because—

(A) it provides for a sale in lieu of an exchange, or

(B) the property to be acquired as replacement property was not identified under such contract before June 9, 1997.

SEC. 1053. HOLDING PERIOD REQUIREMENT FOR CERTAIN FOREIGN TAXES.

(a) IN GENERAL.—Section 901 is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) MINIMUM HOLDING PERIOD FOR CERTAIN TAXES.—

"(1) WITHHOLDING TAXES.—

"(A) IN GENERAL.—In no event shall a credit be allowed under subsection (a) for any withholding tax on a dividend with respect to stock in a corporation if—

"(i) such stock is held by the recipient of the dividend for 15 days or less during the 30-day period beginning on the date which is 15 days before the date on which such share becomes ex-dividend with respect to such dividend, or

"(ii) to the extent that the recipient of the dividend is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

"(B) WITHHOLDING TAX.—For purposes of this paragraph, the term 'withholding tax' includes any tax determined on a gross basis; but does not include any tax which is in the nature of a prepayment of a tax imposed on a net basis.

"(2) DEEMED PAID TAXES.—In the case of income, war profits, or excess profits taxes deemed paid under section 853, 902, or 960 through a chain of ownership of stock in 1 or more corporations, no credit shall be allowed under subsection (a) for such taxes if—

"(A) any stock of any corporation in such chain (the ownership of which is required to obtain credit under subsection (a) for such taxes) is held for less than the period described in paragraph (1)(A)(i), or

"(B) the corporation holding the stock is under an obligation referred to in paragraph (1)(A)(ii).

"(3) 45-DAY RULE IN THE CASE OF CERTAIN PREFERENCE DIVIDENDS.—In the case of stock having preference in dividends and dividends with respect to such stock which are attributable to a period or periods aggregating in excess of 366 days, paragraph (1)(A)(i) shall be applied—

"(A) by substituting '45 days' for '15 days' each place it appears, and

"(B) by substituting '90-day period' for '30-day period'.

"(4) EXCEPTION FOR CERTAIN TAXES PAID BY SECURITIES DEALERS.—

"(A) IN GENERAL.—Paragraphs (1) and (2) shall not apply to any qualified tax with respect to any security held

in the active conduct in a foreign country of a securities business of any person—

"(i) who is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934,

"(ii) who is registered as a Government securities broker or dealer under section 15C(a) of such Act, or

"(iii) who is licensed or authorized in such foreign country to conduct securities activities in such country and is subject to bona fide regulation by a securities regulating authority of such country.

"(B) QUALIFIED TAX.—For purposes of subparagraph (A), the term 'qualified tax' means a tax paid to a foreign country (other than the foreign country referred to in subparagraph (A)) if—

"(i) the dividend to which such tax is attributable is subject to taxation on a net basis by the country referred to in subparagraph (A), and

"(ii) such country allows a credit against its net basis tax for the full amount of the tax paid to such other foreign country.

"(C) REGULATIONS.—The Secretary may prescribe such regulations as may be appropriate to carry out this paragraph, including regulations to prevent the abuse of the exception provided by this paragraph and to treat other taxes as qualified taxes.

"(5) CERTAIN RULES TO APPLY.—For purposes of this subsection, the rules of paragraphs (3) and (4) of section 246(c) shall apply.

"(6) TREATMENT OF BONA FIDE SALES.—If a person's holding period is reduced by reason of the application of the rules of section 246(c)(4) to any contract for the bona fide sale of stock, the determination of whether such person's holding period meets the requirements of paragraph (2) with respect to taxes deemed paid under section 902 or 960 shall be made as of the date such contract is entered into.

"(7) TAXES ALLOWED AS DEDUCTION, ETC.—Sections 275 and 78 shall not apply to any tax which is not allowable as a credit under subsection (a) by reason of this subsection.".

(b) NOTICE OF WITHHOLDING TAXES PAID BY REGULATED INVESTMENT COMPANY.—Subsection (c) of section 853 (relating to foreign tax credit allowed to shareholders) is amended by adding at the end the following new sentence: "Such notice shall also include the amount of such taxes which (without regard to the election under this section) would not be allowable as a credit under section 901(a) to the regulated investment company by reason of section 901(k).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dividends paid or accrued more than 30 days after the date of the enactment of this Act.

SEC. 1054. DENIAL OF TREATY BENEFITS FOR CERTAIN PAYMENTS THROUGH HYBRID ENTITIES.

(a) IN GENERAL.—Section 894 (relating to income affected by treaty) is amended by inserting after subsection (b) the following new subsection:

"(c) DENIAL OF TREATY BENEFITS FOR CERTAIN PAYMENTS THROUGH HYBRID ENTITIES.—

"(1) APPLICATION TO CERTAIN PAYMENTS.—A foreign person shall not be entitled under any income tax treaty of the United States with a foreign country to any reduced rate of any withholding tax imposed by this title on an item of income derived through an entity which is treated as a partnership (or is otherwise treated as fiscally transparent) for purposes of this title if—

"(A) such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person,

"(B) the treaty does not contain a provision addressing the applicability of the treaty in the case of an item of income derived through a partnership, and

"(C) the foreign country does not impose tax on a distribution of such item of income from such entity to such person.

"(2) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to determine the extent to which a taxpayer to which paragraph (1) does not apply shall not be entitled to benefits under any income tax treaty of the United States with respect to any payment received by, or income attributable to any activities of, an entity organized in any jurisdiction (including the United States) that is treated as a partnership or is otherwise treated as fiscally transparent for purposes of this title (including a common investment trust under section 584, a grantor trust, or an entity that is disregarded for purposes of this title) and is treated as fiscally nontransparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply upon the date of enactment of this Act.

SEC. 1055. INTEREST ON UNDERPAYMENTS NOT REDUCED BY FOREIGN TAX CREDIT CARRYBACKS.

(a) IN GENERAL.—Subsection (d) of section 6601 is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) FOREIGN TAX CREDIT CARRYBACKS.—If any credit allowed for any taxable year is increased by reason of a carryback of tax paid or accrued to foreign countries or possessions of the United States, such increase shall not affect the computation of interest under this section for the period ending with the filing date for the taxable year in which such taxes were in fact paid or accrued, or, with respect to any portion of such credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such increase shall not affect the computation of

interest under this section for the period ending with the filing date for such subsequent taxable year.".

(b) CONFORMING AMENDMENT TO REFUNDS ATTRIBUTABLE TO FOREIGN TAX CREDIT CARRYBACKS.—

(1) IN GENERAL.—Subsection (f) of section 6611 is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) FOREIGN TAX CREDIT CARRYBACKS.—For purposes of subsection (a), if any overpayment of tax imposed by subtitle A results from a carryback of tax paid or accrued to foreign countries or possessions of the United States, such overpayment shall be deemed not to have been made before the filing date for the taxable year in which such taxes were in fact paid or accrued, or, with respect to any portion of such credit carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such overpayment shall be deemed not to have been made before the filing date for such subsequent taxable year.".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (4) of section 6611(f) (as so redesignated) is amended—

(i) by striking "PARAGRAPHS (1) AND (2)" and inserting "PARAGRAPHS (1), (2), AND (3)", and

(ii) by striking "paragraph (1) or (2)" each place it appears and inserting "paragraph (1), (2), or (3)".

(B) Clause (ii) of section 6611(f)(4)(B) (as so redesignated) is amended by striking "and" at the end of subclause (I), by redesignating subclause (II) as subclause (III), and by inserting after subclause (I) the following new subclause:

"(II) in the case of a carryback of taxes paid or accrued to foreign countries or possessions of the United States, the taxable year in which such taxes were in fact paid or accrued (or, with respect to any portion of such carryback from a taxable year attributable to a net operating loss carryback or a capital loss carryback from a subsequent taxable year, such subsequent taxable year), and".

(C) Subclause (III) of section 6611(f)(4)(B)(ii) (as so redesignated) is amended by inserting "(as defined in paragraph (3)(B))" after "credit carryback" the first place it appears.

(D) Section 6611 is amended by striking subsection (g) and by redesignating subsections (h) and (i) as subsections (g) and (h), respectively.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to foreign tax credit carrybacks arising in taxable years beginning after the date of the enactment of this Act.

SEC. 1056. CLARIFICATION OF PERIOD OF LIMITATIONS ON CLAIM FOR CREDIT OR REFUND ATTRIBUTABLE TO FOREIGN TAX CREDIT CARRYFORWARD.

(a) IN GENERAL.—Subparagraph (A) of section 6511(d)(3) is amended by striking "for the year with respect to which the claim

is made" and inserting "for the year in which such taxes were actually paid or accrued".

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

SEC. 1057. REPEAL OF EXCEPTION TO ALTERNATIVE MINIMUM FOREIGN TAX CREDIT LIMIT.

(a) IN GENERAL.—Section 59(a)(2) (relating to limitation to 90 percent of tax) is amended by striking subparagraph (C).

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

Subtitle G—Partnership Provisions

SEC. 1061. ALLOCATION OF BASIS AMONG PROPERTIES DISTRIBUTED BY PARTNERSHIP.

(a) IN GENERAL.—Subsection (c) of section 732 is amended to read as follows:

"(c) ALLOCATION OF BASIS.—

"(1) IN GENERAL.—The basis of distributed properties to which subsection (a)(2) or (b) is applicable shall be allocated—

"(A)(i) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)(2)) in an amount equal to the adjusted basis of each such property to the partnership, and

"(ii) if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, then, to the extent any decrease is required in order to have the adjusted bases of such properties equal the basis to be allocated, in the manner provided in paragraph (3), and

"(B) to the extent of any basis remaining after the allocation under subparagraph (A), to other distributed properties—

"(i) first by assigning to each such other property such other property's adjusted basis to the partnership, and

"(ii) then, to the extent any increase or decrease in basis is required in order to have the adjusted bases of such other distributed properties equal such remaining basis, in the manner provided in paragraph (2) or (3), whichever is appropriate.

"(2) METHOD OF ALLOCATING INCREASE.—Any increase required under paragraph (1)(B) shall be allocated among the properties—

"(A) first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation), and

"(B) then, to the extent such increase is not allocated under subparagraph (A), in proportion to their respective fair market values.

"(3) METHOD OF ALLOCATING DECREASE.—Any decrease required under paragraph (1)(A) or (1)(B) shall be allocated—

"(A) first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation), and

"(B) then, to the extent such decrease is not allocated under subparagraph (A), in proportion to their respective adjusted bases (as adjusted under subparagraph (A)).".

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

SEC. 1062. REPEAL OF REQUIREMENT THAT INVENTORY BE SUBSTANTIALLY APPRECIATED WITH RESPECT TO SALE OR EXCHANGE OF PARTNERSHIP INTEREST.

(a) IN GENERAL.—Paragraph (2) of section 751(a) is amended to read as follows:

"(2) inventory items of the partnership,".

(b) CONFORMING AMENDMENTS.—

(1)(A) Paragraph (1) of section 751(b) is amended by striking subparagraphs (A) and (B) and inserting the following new subparagraphs:

"(A) partnership property which is—

"(i) unrealized receivables, or

"(ii) inventory items which have appreciated substantially in value,

in exchange for all or a part of his interest in other partnership property (including money), or

"(B) partnership property (including money) other than property described in subparagraph (A)(i) or (ii) in exchange for all or a part of his interest in partnership property described in subparagraph (A)(i) or (ii),".

(B) Subsection (b) of section 751 is amended by adding at the end the following new paragraph:

"(3) SUBSTANTIAL APPRECIATION.—For purposes of paragraph (1)—

"(A) IN GENERAL.—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds 120 percent of the adjusted basis to the partnership of such property.

"(B) CERTAIN PROPERTY EXCLUDED.—For purposes of subparagraph (A), there shall be excluded any inventory property if a principal purpose for acquiring such property was to avoid the provisions of this subsection relating to inventory items."

(2) Subsection (d) of section 751 is amended to read as follows:

"(d) INVENTORY ITEMS.—For purposes of this subchapter, the term 'inventory items' means—

"(1) property of the partnership of the kind described in section 1221(1),

"(2) any other property of the partnership which, on sale or exchange by the partnership, would be considered property

other than a capital asset and other than property described in section 1231,

"(3) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under subsection (a) of section 1246 (relating to gain on foreign investment company stock), and

"(4) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in paragraph (1), (2), or (3).".

(3) Sections 724(d)(2), 731(a)(2)(B), 731(c)(6), 732(c)(1)(A) (as amended by the preceding section), 735(a)(2), and 735(c)(1) are each amended by striking "section 751(d)(2)" and inserting "section 751(d)".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to sales, exchanges, and distributions after the date of the enactment of this Act.

(2) BINDING CONTRACTS.—The amendments made by this section shall not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

SEC. 1063. EXTENSION OF TIME FOR TAXING PRECONTRIBUTION GAIN.

(a) IN GENERAL.—Sections 704(c)(1)(B) and 737(b)(1) are each amended by striking "5 years" and inserting "7 years".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to property contributed to a partnership after June 8, 1997.

(2) BINDING CONTRACTS.—The amendment made by subsection (a) shall not apply to any property contributed pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution if such contract provides for the contribution of a fixed amount of property.

Subtitle H—Pension Provisions

SEC. 1071. PENSION ACCRUED BENEFIT DISTRIBUTABLE WITHOUT CONSENT INCREASED TO $5,000.

(a) AMENDMENT TO 1986 CODE.—

(1) IN GENERAL.—Subparagraph (A) of section 411(a)(11) (relating to restrictions on certain mandatory distributions) is amended by striking "$3,500" and inserting "$5,000".

(2) CONFORMING AMENDMENTS.—

(A) Section 411(a)(7)(B), paragraphs (1) and (2) of section 417(e), and section 457(e)(9) are each amended by striking "$3,500" each place it appears (other than the headings) and inserting "the dollar limit under section 411(a)(11)(A)".

(B) The headings for paragraphs (1) and (2) of section 417(e) and subparagraph (A) of section 457(e)(9) are each amended by striking "$3,500" and inserting "DOLLAR LIMIT".

(b) AMENDMENTS TO ERISA.—

(1) IN GENERAL.—Section 203(e)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(e)(1)) is amended by striking "$3,500" and inserting "$5,000".

(2) CONFORMING AMENDMENTS.—Sections 204(d)(1) and 205(g) (1) and (2) (29 U.S.C. 1054(d)(1) and 1055(g) (1) and (2)) are each amended by striking "$3,500" and inserting "the dollar limit under section 203(e)(1)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after the date of the enactment of this Act.

SEC. 1072. ELECTION TO RECEIVE TAXABLE CASH COMPENSATION IN LIEU OF NONTAXABLE PARKING BENEFITS.

(a) IN GENERAL.—Section 132(f)(4) (relating to benefits not in lieu of compensation) is amended by adding at the end the following new sentence: "This paragraph shall not apply to any qualified parking provided in lieu of compensation which otherwise would have been includible in gross income of the employee, and no amount shall be included in the gross income of the employee solely because the employee may choose between the qualified parking and compensation.".

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

SEC. 1073. REPEAL OF EXCESS DISTRIBUTION AND EXCESS RETIREMENT ACCUMULATION TAX.

(a) REPEAL OF EXCESS DISTRIBUTION AND EXCESS RETIREMENT ACCUMULATION TAX.—Section 4980A (relating to excess distributions from qualified retirement plans) is repealed.

(b) CONFORMING AMENDMENTS.—

(1) Section 691(c)(1) is amended by striking subparagraph (C).

(2) Section 2013 is amended by striking subsection (g).

(3) Section 2053(c)(1)(B) is amended by striking the last sentence.

(4) Section 6018(a) is amended by striking paragraph (4).

(c) EFFECTIVE DATES.—

(1) EXCESS DISTRIBUTION TAX REPEAL.—Except as provided in paragraph (2), the repeal made by subsection (a) shall apply to excess distributions received after December 31, 1996.

(2) EXCESS RETIREMENT ACCUMULATION TAX REPEAL.—The repeal made by subsection (a) with respect to section 4980A(d) of the Internal Revenue Code of 1986 and the amendments made by subsection (b) shall apply to estates of decedents dying after December 31, 1996.

SEC. 1074. INCREASE IN TAX ON PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—Section 4975(a) is amended by striking "10 percent" and inserting "15 percent".

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

SEC. 1075. BASIS RECOVERY RULES FOR ANNUITIES OVER MORE THAN ONE LIFE.

(a) IN GENERAL.—Section 72(d)(1)(B) is amended by adding at the end the following new clause:

"(iv) NUMBER OF ANTICIPATED PAYMENTS WHERE MORE THAN ONE LIFE.—If the annuity is payable over the lives of more than 1 individual, the number of anticipated payments shall be determined as follows:

"If the combined ages of annuitants are:	*The number is:*
Not more than 110	*410*
More than 110 but not more than 120	*360*
More than 120 but not more than 130	*310*
More than 130 but not more than 140	*260*
More than 140	*210.".*

(b) CONFORMING AMENDMENT.—Section 72(d)(1)(B)(iii) is amended—

(1) by inserting "If the annuity is payable over the life of a single individual, the number of anticipated payments shall be determined as follows:" after the heading and before the table, and

(2) by striking "primary" in the table.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to annuity starting dates beginning after December 31, 1997.

Subtitle I—Other Revenue Provisions

SEC. 1081. TERMINATION OF SUSPENSE ACCOUNTS FOR FAMILY CORPORATIONS REQUIRED TO USE ACCRUAL METHOD OF ACCOUNTING.

(a) IN GENERAL.—Subsection (i) of section 447 (relating to method of accounting for corporations engaged in farming) is amended by striking paragraphs (3) and (4), by redesignating paragraphs (5) and (6) as paragraphs (3) and (4), respectively, and by adding at the end the following new paragraph:

"(5) TERMINATION.—

"(A) IN GENERAL.—No suspense account may be established under this subsection by any corporation required by this section to change its method of accounting for any taxable year ending after June 8, 1997.

"(B) PHASEOUT OF EXISTING SUSPENSE ACCOUNTS.—

"(i) IN GENERAL.—Each suspense account under this subsection shall be reduced (but not below zero) for each taxable year beginning after June 8, 1997, by an amount equal to the lesser of—

"(I) the applicable portion of such account, or

"(II) 50 percent of the taxable income of the corporation for the taxable year, or, if the corporation has no taxable income for such year, the amount of any net operating loss (as defined in section 172(c)) for such taxable year.

For purposes of the preceding sentence, the amount of taxable income and net operating loss shall be determined without regard to this paragraph.

"(ii) COORDINATION WITH OTHER REDUCTIONS.—The amount of the applicable portion for any taxable year shall be reduced (but not below zero) by the

amount of any reduction required for such taxable year under any other provision of this subsection.

"(iv) INCLUSION IN INCOME.—Any reduction in a suspense account under this paragraph shall be included in gross income for the taxable year of the reduction.

"(C) APPLICABLE PORTION.—For purposes of subparagraph (B), the term 'applicable portion' means, for any taxable year, the amount which would ratably reduce the amount in the account (after taking into account prior reductions) to zero over the period consisting of such taxable year and the remaining taxable years in such first 20 taxable years.

"(D) AMOUNTS AFTER 20TH YEAR.—Any amount in the account as of the close of the 20th year referred to in subparagraph (C) shall be treated as the applicable portion for each succeeding year thereafter to the extent not reduced under this paragraph for any prior taxable year after such 20th year.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after June 8, 1997.

SEC. 1082. MODIFICATION OF TAXABLE YEARS TO WHICH NET OPERATING LOSSES MAY BE CARRIED.

(a) IN GENERAL.—Subparagraph (A) of section 172(b)(1) (relating to years to which loss may be carried) is amended—

(1) by striking "3" in clause (i) and inserting "2", and

(2) by striking "15" in clause (ii) and inserting "20".

(b) RETENTION OF 3-YEAR CARRYBACK FOR CERTAIN LOSSES.—Paragraph (1) of section 172(b) is amended by adding at the end the following new subparagraph:

"(F) RETENTION OF 3-YEAR CARRYBACK IN CERTAIN CASES.—

"(i) IN GENERAL.—Subparagraph (A)(i) shall be applied by substituting '3 years' for '2 years' with respect to the portion of the net operating loss for the taxable year which is an eligible loss with respect to the taxpayer.

"(ii) ELIGIBLE LOSS.—For purposes of clause (i), the term 'eligible loss' means—

"(I) in the case of an individual, losses of property arising from fire, storm, shipwreck, or other casualty, or from theft,

"(II) in the case of a taxpayer which is a small business, net operating losses attributable to Presidentially declared disasters (as defined in section 1033(h)(3)), and

"(III) in the case of a taxpayer engaged in the trade or business of farming (as defined in section 263A(e)(4)), net operating losses attributable to such Presidentially declared disasters.

"(iii) SMALL BUSINESS.—For purposes of this subparagraph, the term 'small business' means a corporation or partnership which meets the gross receipts test of section 448(c) for the taxable year in which the loss

arose (or, in the case of a sole proprietorship, which would meet such test if such proprietorship were a corporation).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to net operating losses for taxable years beginning after the date of the enactment of this Act.

SEC. 1083. MODIFICATIONS TO TAXABLE YEARS TO WHICH UNUSED CREDITS MAY BE CARRIED.

(a) IN GENERAL.—Section 39(a) (relating to unused credits) is amended—

(1) in paragraph (1), by striking "3" each place it appears and inserting "1" and by striking "15" each place it appears and inserting "20"; and

(2) in paragraph (2), by striking "18" each place it appears and inserting "22" and by striking "17" each place it appears and inserting "21".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to credits arising in taxable years beginning after December 31, 1997.

SEC. 1084. EXPANSION OF DENIAL OF DEDUCTION FOR CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE.

(a) DENIAL OF DEDUCTION FOR PREMIUMS.—

(1) IN GENERAL.—Paragraph (1) of section 264(a) is amended to read as follows:

"(1) Premiums on any life insurance policy, or endowment or annuity contract, if the taxpayer is directly or indirectly a beneficiary under the policy or contract.".

(2) EXCEPTIONS.—Section 264 is amended by redesignating subsections (b), (c), and (d) as subsections (c), (d), and (e), respectively, and by inserting after subsection (a) the following new subsection:

"(b) EXCEPTIONS TO SUBSECTION (a)(1).—Subsection (a)(1) shall not apply to—

"(1) any annuity contract described in section 72(s)(5), and

"(2) any annuity contract to which section 72(u) applies.".

(b) INTEREST ON POLICY LOANS.—

(1) IN GENERAL.—Paragraph (4) of section 264(a) is amended by striking "individual, who" and all that follows and inserting "individual.".

(2) COORDINATION WITH TRANSFERS FOR VALUE.—Paragraph (2) of section 101(a) is amended by adding at the end the following new flush sentence:

"The term 'other amounts' in the first sentence of this paragraph includes interest paid or accrued by the transferee on indebtedness with respect to such contract or any interest therein if such interest paid or accrued is not allowable as a deduction by reason of section 264(a)(4).".

(c) PRO RATA ALLOCATION OF INTEREST EXPENSE TO POLICY CASH VALUES.—Section 264 is amended by adding at the end the following new subsection:

"(f) PRO RATA ALLOCATION OF INTEREST EXPENSE TO POLICY CASH VALUES.—

"(1) IN GENERAL.—No deduction shall be allowed for that portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values.

"(2) ALLOCATION.—For purposes of paragraph (1), the portion of the taxpayer's interest expense which is allocable to unborrowed policy cash values is an amount which bears the same ratio to such interest expense as—

"(A) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, bears to

"(B) the sum of—

"(i) in the case of assets of the taxpayer which are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values of such policies and contracts, and

"(ii) in the case of assets of the taxpayer not described in clause (i), the average adjusted bases (within the meaning of section 1016) of such assets.

"(3) UNBORROWED POLICY CASH VALUE.—For purposes of this subsection, the term 'unborrowed policy cash value' means, with respect to any life insurance policy or annuity or endowment contract, the excess of—

"(A) the cash surrender value of such policy or contract determined without regard to any surrender charge, over

"(B) the amount of any loan with respect to such policy or contract.

"(4) EXCEPTION FOR CERTAIN POLICIES AND CONTRACTS.—

"(A) POLICIES AND CONTRACTS COVERING 20-PERCENT OWNERS, OFFICERS, DIRECTORS, AND EMPLOYEES.—Paragraph (1) shall not apply to any policy or contract owned by an entity engaged in a trade or business if such policy or contract covers only 1 individual and if such individual is (at the time first covered by the policy or contract)—

"(i) a 20-percent owner of such entity, or

"(ii) an individual (not described in clause (i)) who is an officer, director, or employee of such trade or business.

A policy or contract covering a 20-percent owner of such entity shall not be treated as failing to meet the requirements of the preceding sentence by reason of covering the joint lives of such owner and such owner's spouse.

"(B) CONTRACTS SUBJECT TO CURRENT INCOME INCLUSION.—Paragraph (1) shall not apply to any annuity contract to which section 72(u) applies.

"(C) COORDINATION WITH PARAGRAPH (2).—Any policy or contract to which paragraph (1) does not apply by reason of this paragraph shall not be taken into account under paragraph (2).

"(D) 20-PERCENT OWNER.—For purposes of subparagraph (A), the term '20-percent owner' has the meaning given such term by subsection (e)(4).

"(5) EXCEPTION FOR POLICIES AND CONTRACTS HELD BY NATURAL PERSONS; TREATMENT OF PARTNERSHIPS AND S CORPORATIONS.—

"(A) POLICIES AND CONTRACTS HELD BY NATURAL PERSONS.—

"(i) IN GENERAL.—This subsection shall not apply to any policy or contract held by a natural person.

"(ii) EXCEPTION WHERE BUSINESS IS BENEFICIARY.—If a trade or business is directly or indirectly the beneficiary under any policy or contract, such policy or contract shall be treated as held by such trade or business and not by a natural person.

"(iii) SPECIAL RULES.—

"(I) CERTAIN TRADES OR BUSINESSES NOT TAKEN INTO ACCOUNT.—Clause (ii) shall not apply to any trade or business carried on as a sole proprietorship and to any trade or business performing services as an employee.

"(II) LIMITATION ON UNBORROWED CASH VALUE.—The amount of the unborrowed cash value of any policy or contract which is taken into account by reason of clause (ii) shall not exceed the benefit to which the trade or business is directly or indirectly entitled under the policy or contract.

"(iv) REPORTING.—The Secretary shall require such reporting from policyholders and issuers as is necessary to carry out clause (ii). Any report required under the preceding sentence shall be treated as a statement referred to in section 6724(d)(1).

"(B) TREATMENT OF PARTNERSHIPS AND S CORPORATIONS.—In the case of a partnership or S corporation, this subsection shall be applied at the partnership and corporate levels.

"(6) SPECIAL RULES.—

"(A) COORDINATION WITH SUBSECTION (a) AND SECTION 265.—If interest on any indebtedness is disallowed under subsection (a) or section 265—

"(i) such disallowed interest shall not be taken into account for purposes of applying this subsection, and

"(ii) the amount otherwise taken into account under paragraph (2)(B) shall be reduced (but not below zero) by the amount of such indebtedness.

"(B) COORDINATION WITH SECTION 263A.—This subsection shall be applied before the application of section 263A (relating to capitalization of certain expenses where taxpayer produces property).

"(7) INTEREST EXPENSE.—The term 'interest expense' means the aggregate amount allowable to the taxpayer as a deduction for interest (within the meaning of section 265(b)(4)) for the taxable year (determined without regard to this subsection, section 265(b), and section 291).

"(8) AGGREGATION RULES.—

"(A) IN GENERAL.—All members of a controlled group (within the meaning of subsection (d)(5)(B)) shall be treated as 1 taxpayer for purposes of this subsection.

"(B) TREATMENT OF INSURANCE COMPANIES.—This subsection shall not apply to an insurance company subject to

tax under subchapter L, and subparagraph (A) shall be applied without regard to any member of an affiliated group which is an insurance company.”.

(b) TREATMENT OF INSURANCE COMPANIES.—

(1)(A) Clause (ii) of section 805(a)(4)(C) is amended by inserting “, or out of the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,” after “tax-exempt interest”.

(B) Clause (iii) of section 805(a)(4)(D) is amended by striking “and” and inserting “, the increase for the taxable year in policy cash values (within the meaning of subparagraph (F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies, and”.

(C) Paragraph (4) of section 805(a) is amended by adding at the end the following new subparagraph:

“(F) INCREASE IN POLICY CASH VALUES.—For purposes of subparagraphs (C) and (D)—

“(i) IN GENERAL.—The increase in the policy cash value for any taxable year with respect to policy or contract is the amount of the increase in the adjusted cash value during such taxable year determined without regard to—

“(I) gross premiums paid during such taxable year, and

“(II) distributions (other than amounts includible in the policyholder’s gross income) during such taxable year to which section 72(e) applies.

“(ii) ADJUSTED CASH VALUE.—For purposes of clause (i), the term ‘adjusted cash value’ means the cash surrender value of the policy or contract increased by the sum of—

“(I) commissions payable with respect to such policy or contract for the taxable year, and

“(II) asset management fees, surrender charges, mortality and expense charges, and any other fees or charges specified in regulations prescribed by the Secretary which are imposed (or which would be imposed were the policy or contract canceled) with respect to such policy or contract for the taxable year.”.

(2)(A) Subparagraph (B) of section 807(a)(2) is amended by striking “interest,” and inserting “interest and the amount of the policyholder’s share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,”.

(B) Subparagraph (B) of section 807(b)(1) is amended by striking “interest,” and inserting “interest and the amount of the policyholder’s share of the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies,”.

(3) Paragraph (1) of section 812(d) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by adding at the end the following new subparagraph:

"(D) the increase for any taxable year in the policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies.".

(4) Subparagraph (B) of section 832(b)(5) is amended by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting ", and", and by adding at the end the following new clause:

"(iii) the increase for the taxable year in policy cash values (within the meaning of section 805(a)(4)(F)) of life insurance policies and annuity and endowment contracts to which section 264(f) applies.".

(c) CONFORMING AMENDMENT.—Subparagraph (A) of section 265(b)(4) is amended by inserting ", section 264," before "and section 291".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts issued after June 8, 1997, in taxable years ending after such date. For purposes of the preceding sentence, any material increase in the death benefit or other material change in the contract shall be treated as a new contract but the addition of covered lives shall be treated as a new contract only with respect to such additional covered lives. For purposes of this subsection, an increase in the death benefit under a policy or contract issued in connection with a lapse described in section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 shall not be treated as a new contract.

SEC. 1085. IMPROVED ENFORCEMENT OF THE APPLICATION OF THE EARNED INCOME CREDIT.

(a) RESTRICTIONS ON AVAILABILITY OF EARNED INCOME CREDIT FOR TAXPAYERS WHO IMPROPERLY CLAIMED CREDIT IN PRIOR YEAR.—

(1) IN GENERAL.—Section 32 is amended by redesignating subsections (k) and (l) as subsections (l) and (m), respectively, and by inserting after subsection (j) the following new subsection:

"(k) RESTRICTIONS ON TAXPAYERS WHO IMPROPERLY CLAIMED CREDIT IN PRIOR YEAR.—

"(1) TAXPAYERS MAKING PRIOR FRAUDULENT OR RECKLESS CLAIMS.—

"(A) IN GENERAL.—No credit shall be allowed under this section for any taxable year in the disallowance period.

"(B) DISALLOWANCE PERIOD.—For purposes of paragraph (1), the disallowance period is—

"(i) the period of 10 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this section was due to fraud, and

"(ii) the period of 2 taxable years after the most recent taxable year for which there was a final determination that the taxpayer's claim of credit under this

section was due to reckless or intentional disregard of rules and regulations (but not due to fraud).

"(2) TAXPAYERS MAKING IMPROPER PRIOR CLAIMS.—In the case of a taxpayer who is denied credit under this section for any taxable year as a result of the deficiency procedures under subchapter B of chapter 63, no credit shall be allowed under this section for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for such credit.".

(2) DUE DILIGENCE REQUIREMENT ON INCOME TAX RETURN PREPARERS.—Section 6695 is amended by adding at the end the following new subsection:

"(g) FAILURE TO BE DILIGENT IN DETERMINING ELIGIBILITY FOR EARNED INCOME CREDIT.—Any person who is an income tax return preparer with respect to any return or claim for refund who fails to comply with due diligence requirements imposed by the Secretary by regulations with respect to determining eligibility for, or the amount of, the credit allowable by section 32 shall pay a penalty of $100 for each such failure.".

(3) EXTENSION PROCEDURES APPLICABLE TO MATHEMATICAL OR CLERICAL ERRORS.—Paragraph (2) of section 6213(g) (relating to the definition of mathematical or clerical errors) is amended by striking "and" at the end of subparagraph (H), by striking the period at the end of subparagraph (I) and inserting ", and", and by inserting after subparagraph (I) the following new subparagraph:

"(J) an omission of information required by section 32(k)(2) (relating to taxpayers making improper prior claims of earned income credit).".

(b) INCREASE IN NET LOSS DISREGARDED FOR MODIFIED ADJUSTED GROSS INCOME.—Section 32(c)(5)(B)(iv) is amended by striking "50 percent" and inserting "75 percent".

(c) WORKFARE PAYMENTS NOT INCLUDED IN EARNED INCOME.—Section 32(c)(2)(B) is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by adding at the end the following new clause:

"(v) no amount described in subparagraph (A) received for service performed in work activities as defined in section 407(d) of the Social Security Act to which the taxpayer is assigned under any State program under part A of title IV of such Act, but only to the extent such amount is subsidized under such State program.".

(d) CERTAIN NONTAXABLE INCOME INCLUDED IN MODIFIED ADJUSTED GROSS INCOME.—Section 32(c)(5)(B) is amended—

(1) by striking "and" at the end of clause (iii),

(2) by striking the period at the end of clause (iv)(III),

(3) by inserting after clause (iv)(III) the following new clauses:

"(v) interest received or accrued during the taxable year which is exempt from tax imposed by this chapter, and

"(vi) amounts received as a pension or annuity, and any distributions or payments received from an in-

dividual retirement plan, by the taxpayer during the taxable year to the extent not included in gross income.'', and

(4) by adding at the end the following new sentence: ''Clause (vi) shall not include any amount which is not includible in gross income by reason of section 402(c), 403(a)(4), 403(b), 408(d) (3), (4), or (5), or 457(e)(10).''.

(e) EFFECTIVE DATES.—

(1) The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1996.

(2) The amendments made by subsections (b), (c), and (d) shall apply to taxable years beginning after December 31, 1997.

SEC. 1086. LIMITATION ON PROPERTY FOR WHICH INCOME FORECAST METHOD MAY BE USED.

(a) LIMITATION.—Subsection (g) of section 167 is amended by adding at the end the following new paragraph:

''(6) LIMITATION ON PROPERTY FOR WHICH INCOME FORECAST METHOD MAY BE USED.—The depreciation deduction allowable under this section may be determined under the income forecast method or any similar method only with respect to—

''(A) property described in paragraph (3) or (4) of section 168(f),

''(B) copyrights,

''(C) books,

''(D) patents, and

''(E) other property specified in regulations.

Such methods may not be used with respect to any amortizable section 197 intangible (as defined in section 197(c)).''.

(b) DEPRECIATION PERIOD FOR RENT-TO-OWN PROPERTY.—

(1) IN GENERAL.—Subparagraph (A) of section 168(e)(3) (relating to 3-year property) is amended by striking ''and'' at the end of clause (i), by striking the period at the end of clause (ii) and inserting '', and'', and by adding at the end the following new clause:

''(iii) any qualified rent-to-own property.''.

(2) 4-YEAR CLASS LIFE.—The table contained in section 168(g)(3)(B) is amended by inserting before the first item the following new item:

''(A)(iii)	*4 ''.*

(3) DEFINITION OF QUALIFIED RENT-TO-OWN PROPERTY.—Subsection (i) of section 168 is amended by adding at the end the following new paragraph:

''(14) QUALIFIED RENT-TO-OWN PROPERTY.—

''(A) IN GENERAL.—The term 'qualified rent-to-own property' means property held by a rent-to-own dealer for purposes of being subject to a rent-to-own contract.

''(B) RENT-TO-OWN DEALER.—The term 'rent-to-own dealer' means a person that, in the ordinary course of business, regularly enters into rent-to-own contracts with customers for the use of consumer property, if a substantial portion of those contracts terminate and the property is returned to such person before the receipt of all payments re-

quired to transfer ownership of the property from such person to the customer.

"(C) CONSUMER PROPERTY.—The term 'consumer property' means tangible personal property of a type generally used within the home for personal use.

"(D) RENT-TO-OWN CONTRACT.—The term 'rent-to-own contract' means any lease for the use of consumer property between a rent-to-own dealer and a customer who is an individual which—

"(i) is titled 'Rent-to-Own Agreement' or 'Lease Agreement with Ownership Option,' or uses other similar language,

"(ii) provides for level (or decreasing where no payment is less than 40 percent of the largest payment), regular periodic payments (for a payment period which is a week or month),

"(iii) provides that legal title to such property remains with the rent-to-own dealer until the customer makes all the payments described in clause (ii) or early purchase payments required under the contract to acquire legal title to the item of property,

"(iv) provides a beginning date and a maximum period of time for which the contract may be in effect that does not exceed 156 weeks or 36 months from such beginning date (including renewals or options to extend),

"(v) provides for payments within the 156-week or 36-month period that, in the aggregate, generally exceed the normal retail price of the consumer property plus interest,

"(vi) provides for payments under the contract that, in the aggregate, do not exceed $10,000 per item of consumer property,

"(vii) provides that the customer does not have any legal obligation to make all the payments referred to in clause (ii) set forth under the contract, and that at the end of each payment period the customer may either continue to use the consumer property by making the payment for the next payment period or return such property to the rent-to-own dealer in good working order, in which case the customer does not incur any further obligations under the contract and is not entitled to a return of any payments previously made under the contract, and

"(viii) provides that the customer has no right to sell, sublease, mortgage, pawn, pledge, encumber, or otherwise dispose of the consumer property until all the payments stated in the contract have been made.".

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after the date of the enactment of this Act.

SEC. 1087. EXPANSION OF REQUIREMENT THAT INVOLUNTARILY CONVERTED PROPERTY BE REPLACED WITH PROPERTY ACQUIRED FROM AN UNRELATED PERSON.

(a) IN GENERAL.—Subsection (i) of section 1033 is amended to read as follows:

"(i) REPLACEMENT PROPERTY MUST BE ACQUIRED FROM UNRELATED PERSON IN CERTAIN CASES.—

"(1) IN GENERAL.—If the property which is involuntarily converted is held by a taxpayer to which this subsection applies, subsection (a) shall not apply if the replacement property or stock is acquired from a related person. The preceding sentence shall not apply to the extent that the related person acquired the replacement property or stock from an unrelated person during the period applicable under subsection (a)(2)(B).

"(2) TAXPAYERS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to—

"(A) a C corporation,

"(B) a partnership in which 1 or more C corporations own, directly or indirectly (determined in accordance with section 707(b)(3)), more than 50 percent of the capital interest, or profits interest, in such partnership at the time of the involuntary conversion, and

"(C) any other taxpayer if, with respect to property which is involuntarily converted during the taxable year, the aggregate of the amount of realized gain on such property on which there is realized gain exceeds $100,000.

In the case of a partnership, subparagraph (C) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

"(3) RELATED PERSON.—For purposes of this subsection, a person is related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to involuntary conversions occurring after June 8, 1997.

SEC. 1088. TREATMENT OF EXCEPTION FROM INSTALLMENT SALES RULES FOR SALES OF PROPERTY BY A MANUFACTURER TO A DEALER.

(a) IN GENERAL.—Paragraph (2) of section 811(c) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to taxable years beginning more than 1 year after the date of the enactment of this Act.

(2) COORDINATION WITH SECTION 481.—In the case of any taxpayer required by this section to change its method of accounting for any taxable year—

(A) such changes shall be treated as initiated by the taxpayer,

(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account under section 481(a) of the Internal Revenue Code of 1986 shall be taken into account ratably over

the 4 taxable year period beginning with the first taxable year beginning after the date of the enactment of this Act.

SEC. 1089. LIMITATIONS ON CHARITABLE REMAINDER TRUST ELIGIBILITY FOR CERTAIN TRUSTS.

(a) LIMITATION ON NONCHARITABLE DISTRIBUTIONS.—

(1) IN GENERAL.—Paragraphs (1)(A) and (2)(A) of section 664(d) (relating to charitable remainder trusts) are each amended by inserting "nor more than 50 percent" after "not less than 5 percent".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to transfers in trust after June 18, 1997.

(b) MINIMUM CHARITABLE BENEFIT.—

(1) CHARITABLE REMAINDER ANNUITY TRUSTS.—Paragraph (1) of section 664(d) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C), and by adding at the end the following new subparagraph:

"(D) the value (determined under section 7520) of such remainder interest is at least 10 percent of the initial net fair market value of all property placed in the trust."

(2) CHARITABLE REMAINDER UNITRUSTS.—Paragraph (2) of section 664(d) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C), and by adding at the end the following new subparagraph:

"(D) with respect to each contribution of property to the trust, the value (determined under section 7520) of such remainder interest in such property is at least 10 percent of the net fair market value of such property as of the date such property is contributed to the trust.".

(3) VOID OR REFORMED TRUST.—Paragraph (3) of section 2055(e) is amended by adding at the end the following new subparagraph:

"(J) VOID OR REFORMED TRUST IN CASES OF INSUFFICIENT REMAINDER INTERESTS.—In the case of a trust that would qualify (or could be reformed to qualify pursuant to subparagraph (B)) but for failure to satisfy the requirement of paragraph (1)(D) or (2)(D) of section 664(d), such trust may be—

"(i) declared null and void ab initio, or

"(ii) changed by reformation, amendment, or otherwise to meet such requirement by reducing the payout rate or the duration (or both) of any noncharitable beneficiary's interest to the extent necessary to satisfy such requirement,

pursuant to a proceeding that is commenced within the period required in subparagraph (C)(iii). In a case described in clause (i), no deduction shall be allowed under this title for any transfer to the trust and any transactions entered into by the trust prior to being declared void shall be treated as entered into by the transferor."

(4) SEVERANCE OF CERTAIN ADDITIONAL CONTRIBUTIONS.—Subsection (d) of section 664 is amended by adding at the end the following new paragraph:

"(4) SEVERANCE OF CERTAIN ADDITIONAL CONTRIBUTIONS.—If—

"(A) any contribution is made to a trust which before the contribution is a charitable remainder unitrust, and

"(B) such contribution would (but for this paragraph) result in such trust ceasing to be a charitable unitrust by reason of paragraph (2)(D), such contribution shall be treated as a transfer to a separate trust under regulations prescribed by the Secretary."

(5) CONFORMING AMENDMENT.—Section 2055(e)(3)(G) is amended by inserting "(or other proceeding pursuant to subparagraph (J)" after "reformation".

(6) EFFECTIVE DATES.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendments made by this subsection shall apply to transfers in trust after July 28, 1997.

(B) SPECIAL RULE FOR CERTAIN DECEDENTS.—The amendments made by this subsection shall not apply to transfers in trust under the terms of a will (or other testamentary instrument) executed on or before July 28, 1997, if the decedent—

(i) dies before January 1, 1999, without having republished the will (or amended such instrument) by codicil or otherwise, or

(ii) was on July 28, 1997, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

SEC. 1090. EXPANDED SSA RECORDS FOR TAX ENFORCEMENT.

(a) EXPANSION OF COORDINATED ENFORCEMENT EFFORTS OF IRS AND HHS OFFICE OF CHILD SUPPORT ENFORCEMENT.—

(1) STATE REPORTING OF SSN OF CHILD.—Section 454A(e)(4)(D) of the Social Security Act (42 U.S.C. 654a(e)(4)(D)) is amended by striking "the birth date of any child" and inserting "the birth date and, beginning not later than October 1, 1999, the social security number, of any child".

(2) FEDERAL CASE REGISTRY OF CHILD SUPPORT ORDERS.—Section 453(h) of such Act (42 U.S.C. 653(h)) is amended—

(A) in paragraph (2), by adding at the end the following: "Beginning not later than October 1, 1999, the information referred to in paragraph (1) shall include the names and social security numbers of the children of such individuals."; and

(B) by adding at the end the following:

"(3) ADMINISTRATION OF FEDERAL TAX LAWS.—The Secretary of the Treasury shall have access to the information described in paragraph (2) for the purpose of administering those sections of the Internal Revenue Code of 1986 which grant tax benefits based on support or residence of children.".

(3) COORDINATION BETWEEN SECRETARIES.—The Secretary of the Treasury and the Secretary of Health and Human Services shall consult regarding the implementation issues resulting from the amendments made by this subsection, including interim deadlines for States that may be able before October 1,

1999, to provide the data required by such amendments. The Secretaries shall report to Congress on the results of such consultation.

(4) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on October 1, 1998.

(b) REQUIRED SUBMISSION OF SSN'S ON APPLICATIONS.—

(1) IN GENERAL.—Section 205(c)(2) of the Social Security Act (42 U.S.C. 405(c)(2)) is amended—

(A) in subparagraph (B)(ii), by adding at the end the following new sentence: "With respect to an application for a social security account number for an individual who has not attained the age of 18 before such application, such evidence shall include the information described in subparagraph (C)(ii).",

(B) in the second sentence of subparagraph (C)(ii), insert "the Commissioner of Social Security and" after "available to", and

(C) by adding at the end the following new subparagraph:

"(H) The Commissioner of Social Security shall share with the Secretary of the Treasury the information obtained by the Commissioner pursuant to the second sentence of subparagraph (B)(ii) and to subparagraph (C)(ii) for the purpose of administering those sections of the Internal Revenue Code of 1986 which grant tax benefits based on support or residence of children.".

(2) EFFECTIVE DATES.—

(A) The amendment made by paragraph (1)(A) shall apply to applications made after the date which is 180 days after the date of the enactment of this Act.

(B) The amendments made by subparagraphs (B) and (C) of paragraph (1) shall apply to information obtained on, before, or after the date of the enactment of this Act.

SEC. 1091. MODIFICATION OF ESTIMATED TAX SAFE HARBORS.

(a) IN GENERAL.—Clause (i) of section 6654(d)(1)(C) (relating to limitation on use of preceding year's tax) is amended to read as follows:

"(i) IN GENERAL.—If the adjusted gross income shown on the return of the individual for the preceding taxable year beginning in any calendar year exceeds $150,000, clause (ii) of subparagraph (B) shall be applied by substituting the applicable percentage for '100 percent'. For purposes of the preceding sentence, the applicable percentage shall be determined in accordance with the following table:

"If the preceding taxable year begins in:	*The applicable percentage is:*
1998, 1999, or 2000	*105*
2001	*112*
2002 or thereafter	*110.*

This clause shall not apply in the case of a preceding taxable year beginning in calendar year 1997.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to any installment payment for taxable years beginning after December 31, 1997.

TITLE XI—SIMPLIFICATION AND OTHER FOREIGN-RELATED PROVISIONS

Subtitle A—General Provisions

SEC. 1101. CERTAIN INDIVIDUALS EXEMPT FROM FOREIGN TAX CREDIT LIMITATION.

(a) GENERAL RULE.—Section 904 (relating to limitations on foreign tax credit) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) CERTAIN INDIVIDUALS EXEMPT.—

"(1) IN GENERAL.—In the case of an individual to whom this subsection applies for any taxable year—

"(A) the limitation of subsection (a) shall not apply,

"(B) no taxes paid or accrued by the individual during such taxable year may be deemed paid or accrued under subsection (c) in any other taxable year, and

"(C) no taxes paid or accrued by the individual during any other taxable year may be deemed paid or accrued under subsection (c) in such taxable year.

"(2) INDIVIDUALS TO WHOM SUBSECTION APPLIES.—This subsection shall apply to an individual for any taxable year if—

"(A) the entire amount of such individual's gross income for the taxable year from sources without the United States consists of qualified passive income,

"(B) the amount of the creditable foreign taxes paid or accrued by the individual during the taxable year does not exceed $300 ($600 in the case of a joint return), and

"(C) such individual elects to have this subsection apply for the taxable year.

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

"(A) QUALIFIED PASSIVE INCOME.—The term 'qualified passive income' means any item of gross income if—

"(i) such item of income is passive income (as defined in subsection (d)(2)(A) without regard to clause (iii) thereof), and

"(ii) such item of income is shown on a payee statement furnished to the individual.

"(B) CREDITABLE FOREIGN TAXES.—The term 'creditable foreign taxes' means any taxes for which a credit is allowable under section 901; except that such term shall not include any tax unless such tax is shown on a payee statement furnished to such individual.

"(C) PAYEE STATEMENT.—The term 'payee statement' has the meaning given to such term by section 6724(d)(2).

"(D) ESTATES AND TRUSTS NOT ELIGIBLE.—This subsection shall not apply to any estate or trust.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 1102. EXCHANGE RATE USED IN TRANSLATING FOREIGN TAXES.

(a) ACCRUED TAXES TRANSLATED BY USING AVERAGE RATE FOR YEAR TO WHICH TAXES RELATE.—

(1) IN GENERAL.—Subsection (a) of section 986 (relating to translation of foreign taxes) is amended to read as follows:

"(a) FOREIGN INCOME TAXES.—

"(1) TRANSLATION OF ACCRUED TAXES.—

"(A) IN GENERAL.—For purposes of determining the amount of the foreign tax credit, in the case of a taxpayer who takes foreign income taxes into account when accrued, the amount of any foreign income taxes (and any adjustment thereto) shall be translated into dollars by using the average exchange rate for the taxable year to which such taxes relate.

"(B) EXCEPTION FOR CERTAIN TAXES.—Subparagraph (A) shall not apply to any foreign income taxes—

"(i) paid after the date 2 years after the close of the taxable year to which such taxes relate, or

"(ii) paid before the beginning of the taxable year to which such taxes relate.

"(C) EXCEPTION FOR INFLATIONARY CURRENCIES.—Subparagraph (A) shall not apply to any foreign income taxes the liability for which is denominated in any inflationary currency (as determined under regulations).

"(D) CROSS REFERENCE.—

"For adjustments where tax is not paid within 2 years, see section 905(c).

"(2) TRANSLATION OF TAXES TO WHICH PARAGRAPH (1) DOES NOT APPLY.—For purposes of determining to the amount of the foreign tax credit, in the case of any foreign income taxes to which subparagraph (A) of paragraph (1) does not apply—

"(A) such taxes shall be translated into dollars using the exchange rates as of the time such taxes were paid to the foreign country or possession of the United States, and

"(B) any adjustment to the amount of such taxes shall be translated into dollars using—

"(i) except as provided in clause (ii), the exchange rate as of the time when such adjustment is paid to the foreign country or possession, or

"(ii) in the case of any refund or credit of foreign income taxes, using the exchange rate as of the time of the original payment of such foreign income taxes.

"(3) FOREIGN INCOME TAXES.—For purposes of this subsection, the term 'foreign income taxes' means any income, war profits, or excess profits taxes paid or accrued to any foreign country or to any possession of the United States.".

(2) ADJUSTMENT WHEN NOT PAID WITHIN 2 YEARS AFTER YEAR TO WHICH TAXES RELATE.—Subsection (c) of section 905 is amended to read as follows:

"(c) ADJUSTMENTS TO ACCRUED TAXES.—

"(1) IN GENERAL.—If—

"(A) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer,

"(B) accrued taxes are not paid before the date 2 years after the close of the taxable year to which such taxes relate, or

"(C) any tax paid is refunded in whole or in part,

the taxpayer shall notify the Secretary, who shall redetermine the amount of the tax for the year or years affected. The Secretary may prescribe adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings under sections 902 and 960 in lieu of the redetermination under the preceding sentence.

"(2) SPECIAL RULE FOR TAXES NOT PAID WITHIN 2 YEARS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in making the redetermination under paragraph (1), no credit shall be allowed for accrued taxes not paid before the date referred to in subparagraph (B) of paragraph (1).

"(B) TAXES SUBSEQUENTLY PAID.—Any such taxes if subsequently paid—

"(i) shall be taken into account—

"(I) in the case of taxes deemed paid under section 902 or section 960, for the taxable year in which paid (and no redetermination shall be made under this section by reason of such payment), and

"(II) in any other case, for the taxable year to which such taxes relate, and

"(ii) shall be translated as provided in section 986(a)(2)(A).

"(3) ADJUSTMENTS.—The amount of tax (if any) due on any redetermination under paragraph (1) shall be paid by the taxpayer on notice and demand by the Secretary, and the amount of tax overpaid (if any) shall be credited or refunded to the taxpayer in accordance with subchapter B of chapter 66 (section 6511 et seq.).

"(4) BOND REQUIREMENTS.—In the case of any tax accrued but not paid, the Secretary, as a condition precedent to the allowance of the credit provided in this subpart, may require the taxpayer to give a bond, with sureties satisfactory to and approved by the Secretary, in such sum as the Secretary may require, conditioned on the payment by the taxpayer of any amount of tax found due on any such redetermination. Any such bond shall contain such further conditions as the Secretary may require.

"(5) OTHER SPECIAL RULES.—In any redetermination under paragraph (1) by the Secretary of the amount of tax due from the taxpayer for the year or years affected by a refund, the amount of the taxes refunded for which credit has been allowed under this section shall be reduced by the amount of any tax described in section 901 imposed by the foreign country or possession of the United States with respect to such refund; but no credit under this subpart, or deduction under section 164, shall be allowed for any taxable year with respect to any such tax imposed on the refund. No interest shall be assessed or collected on any amount of tax due on any redetermination by the Secretary, resulting from a refund to the taxpayer, for any period before the receipt of such refund, except to the extent interest

was paid by the foreign country or possession of the United States on such refund for such period.".

(b) AUTHORITY TO USE AVERAGE RATES.—

(1) IN GENERAL.—Subsection (a) of section 986 (as amended by subsection (a)) is amended by redesignating paragraph (3) as paragraph (4) and inserting after paragraph (2) the following new paragraph:

"(3) AUTHORITY TO PERMIT USE OF AVERAGE RATES.—To the extent prescribed in regulations, the average exchange rate for the period (specified in such regulations) during which the taxes or adjustment is paid may be used instead of the exchange rate as of the time of such payment.".

(2) DETERMINATION OF AVERAGE RATES.—Subsection (c) of section 989 is amended by striking "and" at the end of paragraph (4), by striking the period at the end of paragraph (5) and inserting ", and", and by adding at the end thereof the following new paragraph:

"(6) setting forth procedures for determining the average exchange rate for any period.".

(3) CONFORMING AMENDMENTS.—Subsection (b) of section 989 is amended by striking "weighted" each place it appears.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by subsections (a)(1) and (b) shall apply to taxes paid or accrued in taxable years beginning after December 31, 1997.

(2) SUBSECTION (a)(2).—The amendment made by subsection (a)(2) shall apply to taxes which relate to taxable years beginning after December 31, 1997.

SEC. 1103. ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION FOR ALTERNATIVE MINIMUM TAX.

(a) GENERAL RULE.—Subsection (a) of section 59 (relating to alternative minimum tax foreign tax credit) is amended by adding at the end thereof the following new paragraph:

"(3) ELECTION TO USE SIMPLIFIED SECTION 904 LIMITATION.—

"(A) IN GENERAL.—In determining the alternative minimum tax foreign tax credit for any taxable year to which an election under this paragraph applies—

"(i) subparagraph (B) of paragraph (1) shall not apply, and

"(ii) the limitation of section 904 shall be based on the proportion which—

"(I) the taxpayer's taxable income (as determined for purposes of the regular tax) from sources without the United States (but not in excess of the taxpayer's entire alternative minimum taxable income), bears to

"(II) the taxpayer's entire alternative minimum taxable income for the taxable year.

"(B) ELECTION.—

"(i) IN GENERAL.—An election under this paragraph may be made only for the taxpayer's first taxable year which begins after December 31, 1997, and for

which the taxpayer claims an alternative minimum tax foreign tax credit.

"(ii) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.".

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

SEC. 1104. TREATMENT OF PERSONAL TRANSACTIONS BY INDIVIDUALS UNDER FOREIGN CURRENCY RULES.

(a) GENERAL RULE.—Subsection (e) of section 988 (relating to application to individuals) is amended to read as follows:

"(e) APPLICATION TO INDIVIDUALS.—

"(1) IN GENERAL.—The preceding provisions of this section shall not apply to any section 988 transaction entered into by an individual which is a personal transaction.

"(2) EXCLUSION FOR CERTAIN PERSONAL TRANSACTIONS.—If—

"(A) nonfunctional currency is disposed of by an individual in any transaction, and

"(B) such transaction is a personal transaction,

no gain shall be recognized for purposes of this subtitle by reason of changes in exchange rates after such currency was acquired by such individual and before such disposition. The preceding sentence shall not apply if the gain which would otherwise be recognized on the transaction exceeds $200.

"(3) PERSONAL TRANSACTIONS.—For purposes of this subsection, the term 'personal transaction' means any transaction entered into by an individual, except that such term shall not include any transaction to the extent that expenses properly allocable to such transaction meet the requirements of—

"(A) section 162 (other than traveling expenses described in subsection (a)(2) thereof), or

"(B) section 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).".

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

SEC. 1105. FOREIGN TAX CREDIT TREATMENT OF DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.

(a) SEPARATE BASKET ONLY TO APPLY TO PRE-2003 EARNINGS.—

(1) IN GENERAL.—Subparagraph (E) of section 904(d)(1) is amended to read as follows:

"(E) in the case of a corporation, dividends from noncontrolled section 902 corporations out of earnings and profits accumulated in taxable years beginning before January 1, 2003,".

(2) AGGREGATION OF NON-PFICS.—Subparagraph (E) of section 904(d)(2) (relating to noncontrolled section 902 corporations) is amended by adding at the end the following new clause:

"(iv) ALL NON-PFICS TREATED AS ONE.—All noncontrolled section 902 corporations which are not passive

foreign investment companies (as defined in section 1297) shall be treated as one noncontrolled section 902 corporation for purposes of paragraph (1).".

(3) CONFORMING AMENDMENTS.—Subparagraphs (C)(iii)(II) and (D) of section 904(d)(2) are each amended by inserting "out of earnings and profits accumulated in taxable years beginning before January 1, 2003" after "corporation".

(b) APPLICATION OF LOOK-THRU RULES TO DIVIDENDS OF NONCONTROLLED SECTION 902 CORPORATIONS ATTRIBUTABLE TO POST-2002 EARNINGS.—Section 904(d) is amended by redesignating paragraphs (4) and (5) as paragraphs (5) and (6), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.—

"(A) IN GENERAL.—For purposes of this subsection, any applicable dividend shall be treated as income in a separate category in proportion to the ratio of—

"(i) the portion of the earnings and profits described in subparagraph (B)(ii) attributable to income in such category, to

"(ii) the total amount of such earnings and profits.

"(B) APPLICABLE DIVIDEND.—For purposes of subparagraph (A), the term 'applicable dividend' means any dividend—

"(i) from a noncontrolled section 902 corporation with respect to the taxpayer, and

"(ii) paid out of earnings and profits accumulated in taxable years beginning after December 31, 2002.

"(C) SPECIAL RULES.—

"(i) IN GENERAL.—Rules similar to the rules of paragraph (3)(F) shall apply for purposes of this paragraph.

"(ii) EARNINGS AND PROFITS.—For purposes of this paragraph and paragraph (1)(E)—

"(I) IN GENERAL.—The rules of section 316 shall apply.

"(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

Subtitle B—Treatment of Controlled Foreign Corporations

SEC. 1111. GAIN ON CERTAIN STOCK SALES BY CONTROLLED FOREIGN CORPORATIONS TREATED AS DIVIDENDS.

(a) GENERAL RULE.—Section 964 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new subsection:

"(e) GAIN ON CERTAIN STOCK SALES BY CONTROLLED FOREIGN CORPORATIONS TREATED AS DIVIDENDS.—

"(1) IN GENERAL.—If a controlled foreign corporation sells or exchanges stock in any other foreign corporation, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend to the same extent that it would have been so included under section 1248(a) if such controlled foreign corporation were a United States person. For purposes of determining the amount which would have been so includible, the determination of whether such other foreign corporation was a controlled foreign corporation shall be made without regard to the preceding sentence.

"(2) SAME COUNTRY EXCEPTION NOT APPLICABLE.—Clause (i) of section 954(c)(3)(A) shall not apply to any amount treated as a dividend by reason of paragraph (1).

"(3) CLARIFICATION OF DEEMED SALES.—For purposes of this subsection, a controlled foreign corporation shall be treated as having sold or exchanged any stock if, under any provision of this subtitle, such controlled foreign corporation is treated as having gain from the sale or exchange of such stock.".

(b) AMENDMENT OF SECTION 904(d).—Clause (i) of section 904(d)(2)(E) is amended by striking "and except as provided in regulations, the taxpayer was a United States shareholder in such corporation".

(c) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall apply to gain recognized on transactions occurring after the date of the enactment of this Act.

(2) The amendment made by subsection (b) shall apply to distributions after the date of the enactment of this Act.

SEC. 1112. MISCELLANEOUS MODIFICATIONS TO SUBPART F.

(a) SECTION 1248 GAIN TAKEN INTO ACCOUNT IN DETERMINING PRO RATA SHARE.—

(1) IN GENERAL.—Paragraph (2) of section 951(a) (defining pro rata share of subpart F income) is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (B), any gain included in the gross income of any person as a dividend under section 1248 shall be treated as a distribution received by such person with respect to the stock involved.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to dispositions after the date of the enactment of this Act.

(b) BASIS ADJUSTMENTS IN STOCK HELD BY FOREIGN CORPORATION.—

(1) IN GENERAL.—Section 961 (relating to adjustments to basis of stock in controlled foreign corporations and of other property) is amended by adding at the end thereof the following new subsection:

"(c) BASIS ADJUSTMENTS IN STOCK HELD BY FOREIGN CORPORATION.—Under regulations prescribed by the Secretary, if a United States shareholder is treated under section 958(a)(2) as owning any stock in a controlled foreign corporation which is actually owned by another controlled foreign corporation, adjustments similar to the adjustments provided by subsections (a) and (b) shall be made to

the basis of such stock in the hands of such other controlled foreign corporation, but only for the purposes of determining the amount included under section 951 in the gross income of such United States shareholder (or any other United States shareholder who acquires from any person any portion of the interest of such United States shareholder by reason of which such shareholder was treated as owning such stock, but only to the extent of such portion, and subject to such proof of identity of such interest as the Secretary may prescribe by regulations).".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply for purposes of determining inclusions for taxable years of United States shareholders beginning after December 31, 1997.

(c) CLARIFICATION OF TREATMENT OF BRANCH TAX EXEMPTIONS OR REDUCTIONS.—

(1) IN GENERAL.—Subsection (b) of section 952 is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, any exemption (or reduction) with respect to the tax imposed by section 884 shall not be taken into account.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1986.

SEC. 1113. INDIRECT FOREIGN TAX CREDIT ALLOWED FOR CERTAIN LOWER TIER COMPANIES.

(a) SECTION 902 CREDIT.—

(1) IN GENERAL.—Subsection (b) of section 902 (relating to deemed taxes increased in case of certain 2nd and 3rd tier foreign corporations) is amended to read as follows:

"(b) DEEMED TAXES INCREASED IN CASE OF CERTAIN LOWER TIER CORPORATIONS.—

"(1) IN GENERAL.—If—

"(A) any foreign corporation is a member of a qualified group, and

"(B) such foreign corporation owns 10 percent or more of the voting stock of another member of such group from which it receives dividends in any taxable year,

such foreign corporation shall be deemed to have paid the same proportion of such other member's post-1986 foreign income taxes as would be determined under subsection (a) if such foreign corporation were a domestic corporation.

"(2) QUALIFIED GROUP.—For purposes of paragraph (1), the term 'qualified group' means—

"(A) the foreign corporation described in subsection (a), and

"(B) any other foreign corporation if—

"(i) the domestic corporation owns at least 5 percent of the voting stock of such other foreign corporation indirectly through a chain of foreign corporations connected through stock ownership of at least 10 percent of their voting stock,

"(ii) the foreign corporation described in subsection (a) is the first tier corporation in such chain, and

"(iii) such other corporation is not below the sixth tier in such chain.

The term 'qualified group' shall not include any foreign corporation below the third tier in the chain referred to in clause (i) unless such foreign corporation is a controlled foreign corporation (as defined in section 957) and the domestic corporation is a United States shareholder (as defined in section 951(b)) in such foreign corporation. Paragraph (1) shall apply to those taxes paid by a member of the qualified group below the third tier only with respect to periods during which it was a controlled foreign corporation.".

(2) CONFORMING AMENDMENTS.—

(A) Subparagraph (B) of section 902(c)(3) is amended by adding "or" at the end of clause (i) and by striking clauses (ii) and (iii) and inserting the following new clause:

"(ii) the requirements of subsection (b)(2) are met with respect to such foreign corporation.".

(B) Subparagraph (B) of section 902(c)(4) is amended by striking "3rd foreign corporation" and inserting "sixth tier foreign corporation".

(C) The heading for paragraph (3) of section 902(c) is amended by striking "WHERE DOMESTIC CORPORATION ACQUIRES 10 PERCENT OF FOREIGN CORPORATION" and inserting "WHERE FOREIGN CORPORATION FIRST QUALIFIES".

(D) Paragraph (3) of section 902(c) is amended by striking "ownership" each place it appears.

(b) SECTION 960 CREDIT.—Paragraph (1) of section 960(a) (relating to special rules for foreign tax credits) is amended to read as follows:

"(1) DEEMED PAID CREDIT.—For purposes of subpart A of this part, if there is included under section 951(a) in the gross income of a domestic corporation any amount attributable to earnings and profits of a foreign corporation which is a member of a qualified group (as defined in section 902(b)) with respect to the domestic corporation, then, except to the extent provided in regulations, section 902 shall be applied as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B)).".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxes of foreign corporations for taxable years of such corporations beginning after the date of enactment of this Act.

(2) SPECIAL RULE.—In the case of any chain of foreign corporations described in clauses (i) and (ii) of section 902(b)(2)(B) of the Internal Revenue Code of 1986 (as amended by this section), no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of the enactment of this Act shall have the effect of permitting taxes to be taken into account under section 902 of the Internal Revenue Code of 1986 which could not have been taken into account under such section but for such transaction.

Subtitle C—Treatment of Passive Foreign Investment Companies

SEC. 1121. UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS NOT SUBJECT TO PFIC INCLUSION.

Section 1296 is amended by adding at the end the following new subsection:

"(e) EXCEPTION FOR UNITED STATES SHAREHOLDERS OF CONTROLLED FOREIGN CORPORATIONS.—

"(1) IN GENERAL.—For purposes of this part, a corporation shall not be treated with respect to a shareholder as a passive foreign investment company during the qualified portion of such shareholder's holding period with respect to stock in such corporation.

"(2) QUALIFIED PORTION.—For purposes of this subsection, the term 'qualified portion' means the portion of the shareholder's holding period—

"(A) which is after December 31, 1997, and

"(B) during which the shareholder is a United States shareholder (as defined in section 951(b)) of the corporation and the corporation is a controlled foreign corporation.

"(3) NEW HOLDING PERIOD IF QUALIFIED PORTION ENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), if the qualified portion of a shareholder's holding period with respect to any stock ends after December 31, 1997, solely for purposes of this part, the shareholder's holding period with respect to such stock shall be treated as beginning as of the first day following such period.

"(B) EXCEPTION.—Subparagraph (A) shall not apply if such stock was, with respect to such shareholder, stock in a passive foreign investment company at any time before the qualified portion of the shareholder's holding period with respect to such stock and no election under section 1298(b)(1) is made.".

SEC. 1122. ELECTION OF MARK TO MARKET FOR MARKETABLE STOCK IN PASSIVE FOREIGN INVESTMENT COMPANY.

(a) IN GENERAL.—Part VI of subchapter P of chapter 1 is amended by redesignating subpart C as subpart D, by redesignating sections 1296 and 1297 as sections 1297 and 1298, respectively, and by inserting after subpart B the following new subpart:

"Subpart C—Election of Mark to Market For Marketable Stock

"SEC. 1296. ELECTION OF MARK TO MARKET FOR MARKETABLE STOCK.

"(a) GENERAL RULE.—In the case of marketable stock in a passive foreign investment company which is owned (or treated under subsection (g) as owned) by a United States person at the close of any taxable year of such person, at the election of such person—

"(1) If the fair market value of such stock as of the close of such taxable year exceeds its adjusted basis, such United States

person shall include in gross income for such taxable year an amount equal to the amount of such excess.

"(2) If the adjusted basis of such stock exceeds the fair market value of such stock as of the close of such taxable year, such United States person shall be allowed a deduction for such taxable year equal to the lesser of—

"(A) the amount of such excess, or

"(B) the unreversed inclusions with respect to such stock.

"(b) BASIS ADJUSTMENTS.—

"(1) IN GENERAL.—The adjusted basis of stock in a passive foreign investment company—

"(A) shall be increased by the amount included in the gross income of the United States person under subsection (a)(1) with respect to such stock, and

"(B) shall be decreased by the amount allowed as a deduction to the United States person under subsection (a)(2) with respect to such stock.

"(2) SPECIAL RULE FOR STOCK CONSTRUCTIVELY OWNED.—In the case of stock in a passive foreign investment company which the United States person is treated as owning under subsection (g)—

"(A) the adjustments under paragraph (1) shall apply to such stock in the hands of the person actually holding such stock but only for purposes of determining the subsequent treatment under this chapter of the United States person with respect to such stock, and

"(B) similar adjustments shall be made to the adjusted basis of the property by reason of which the United States person is treated as owning such stock.

"(c) CHARACTER AND SOURCE RULES.—

"(1) ORDINARY TREATMENT.—

"(A) GAIN.—Any amount included in gross income under subsection (a)(1), and any gain on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect), shall be treated as ordinary income.

"(B) LOSS.—Any—

"(i) amount allowed as a deduction under subsection (a)(2), and

"(ii) loss on the sale or other disposition of marketable stock in a passive foreign investment company (with respect to which an election under this section is in effect) to the extent that the amount of such loss does not exceed the unreversed inclusions with respect to such stock,

shall be treated as an ordinary loss. The amount so treated shall be treated as a deduction allowable in computing adjusted gross income.

"(2) SOURCE.—The source of any amount included in gross income under subsection (a)(1) (or allowed as a deduction under subsection (a)(2)) shall be determined in the same manner as if such amount were gain or loss (as the case may be) from the sale of stock in the passive foreign investment company.

“(d) UNREVERSED INCLUSIONS.—For purposes of this section, the term ‘unreversed inclusions’ means, with respect to any stock in a passive foreign investment company, the excess (if any) of—

“(1) the amount included in gross income of the taxpayer under subsection (a)(1) with respect to such stock for prior taxable years, over

“(2) the amount allowed as a deduction under subsection (a)(2) with respect to such stock for prior taxable years.

The amount referred to in paragraph (1) shall include any amount which would have been included in gross income under subsection (a)(1) with respect to such stock for any prior taxable year but for section 1291.

“(e) MARKETABLE STOCK.—For purposes of this section—

“(1) IN GENERAL.—The term ‘marketable stock’ means—

“(A) any stock which is regularly traded on—

“(i) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

“(ii) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this part,

“(B) to the extent provided in regulations, stock in any foreign corporation which is comparable to a regulated investment company and which offers for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, and

“(C) to the extent provided in regulations, any option on stock described in subparagraph (A) or (B).

“(2) SPECIAL RULE FOR REGULATED INVESTMENT COMPANIES.—In the case of any regulated investment company which is offering for sale or has outstanding any stock of which it is the issuer and which is redeemable at its net asset value, all stock in a passive foreign investment company which it owns directly or indirectly shall be treated as marketable stock for purposes of this section. Except as provided in regulations, similar treatment as marketable stock shall apply in the case of any other regulated investment company which publishes net asset valuations at least annually.

“(f) TREATMENT OF CONTROLLED FOREIGN CORPORATIONS WHICH ARE SHAREHOLDERS IN PASSIVE FOREIGN INVESTMENT COMPANIES.—In the case of a foreign corporation which is a controlled foreign corporation and which owns (or is treated under subsection (g) as owning) stock in a passive foreign investment company—

“(1) this section (other than subsection (c)(2)) shall apply to such foreign corporation in the same manner as if such corporation were a United States person, and

“(2) for purposes of subpart F of part III of subchapter N—

“(A) any amount included in gross income under subsection (a)(1) shall be treated as foreign personal holding company income described in section 954(c)(1)(A), and

"(B) any amount allowed as a deduction under subsection (a)(2) shall be treated as a deduction allocable to foreign personal holding company income so described.

"(g) STOCK OWNED THROUGH CERTAIN FOREIGN ENTITIES.—Except as provided in regulations—

"(1) IN GENERAL.—For purposes of this section, stock owned, directly or indirectly, by or for a foreign partnership or foreign trust or foreign estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

"(2) TREATMENT OF CERTAIN DISPOSITIONS.—In any case in which a United States person is treated as owning stock in a passive foreign investment company by reason of paragraph (1)—

"(A) any disposition by the United States person or by any other person which results in the United States person being treated as no longer owning such stock, and

"(B) any disposition by the person owning such stock, shall be treated as a disposition by the United States person of the stock in the passive foreign investment company.

"(h) COORDINATION WITH SECTION 851(b).—For purposes of paragraphs (2) and (3) of section 851(b), any amount included in gross income under subsection (a) shall be treated as a dividend.

"(i) STOCK ACQUIRED FROM A DECEDENT.—In the case of stock of a passive foreign investment company which is acquired by bequest, devise, or inheritance (or by the decedent's estate) and with respect to which an election under this section was in effect as of the date of the decedent's death, notwithstanding section 1014, the basis of such stock in the hands of the person so acquiring it shall be the adjusted basis of such stock in the hands of the decedent immediately before his death (or, if lesser, the basis which would have been determined under section 1014 without regard to this subsection).

"(j) COORDINATION WITH SECTION 1291 FOR FIRST YEAR OF ELECTION.—

"(1) TAXPAYERS OTHER THAN REGULATED INVESTMENT COMPANIES.—

"(A) IN GENERAL.—If the taxpayer elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, and if the requirements of subparagraph (B) are not satisfied, section 1291 shall apply to—

"(i) any distributions with respect to, or disposition of, such stock in the first taxable year of the taxpayer for which such election is made, and

"(ii) any amount which, but for section 1291, would have been included in gross income under subsection (a) with respect to such stock for such taxable year in the same manner as if such amount were gain on the disposition of such stock.

"(B) REQUIREMENTS.—The requirements of this subparagraph are met if, with respect to each of such corpora-

tion's taxable years for which such corporation was a passive foreign investment company and which begin after December 31, 1986, and included any portion of the taxpayer's holding period in such stock, such corporation was treated as a qualified electing fund under this part with respect to the taxpayer.

"(2) SPECIAL RULES FOR REGULATED INVESTMENT COMPANIES.—

"(A) IN GENERAL.—If a regulated investment company elects the application of this section with respect to any marketable stock in a corporation after the beginning of the taxpayer's holding period in such stock, then, with respect to such company's first taxable year for which such company elects the application of this section with respect to such stock—

"(i) section 1291 shall not apply to such stock with respect to any distribution or disposition during, or amount included in gross income under this section for, such first taxable year, but

"(ii) such regulated investment company's tax under this chapter for such first taxable year shall be increased by the aggregate amount of interest which would have been determined under section 1291(c)(3) if section 1291 were applied without regard to this subparagraph.

Clause (ii) shall not apply if for the preceding taxable year the company elected to mark to market the stock held by such company as of the last day of such preceding taxable year.

"(B) DISALLOWANCE OF DEDUCTION.—No deduction shall be allowed to any regulated investment company for the increase in tax under subparagraph (A)(ii).

"(k) ELECTION.—This section shall apply to marketable stock in a passive foreign investment company which is held by a United States person only if such person elects to apply this section with respect to such stock. Such an election shall apply to the taxable year for which made and all subsequent taxable years unless—

"(1) such stock ceases to be marketable stock, or

"(2) the Secretary consents to the revocation of such election.

"(l) TRANSITION RULE FOR INDIVIDUALS BECOMING SUBJECT TO UNITED STATES TAX.—If any individual becomes a United States person in a taxable year beginning after December 31, 1997, solely for purposes of this section, the adjusted basis (before adjustments under subsection (b)) of any marketable stock in a passive foreign investment company owned by such individual on the first day of such taxable year shall be treated as being the greater of its fair market value on such first day or its adjusted basis on such first day.".

(b) COORDINATION WITH INTEREST CHARGE, ETC.—

(1) Paragraph (1) of section 1291(d) is amended by adding at the end the following new flush sentence:

"Except as provided in section 1296(j), this section also shall not apply if an election under section 1296(k) is in effect for the taxpayer's taxable year.".

(2) The subsection heading for subsection (d) of section 1291 is amended by striking "SUBPART B" and inserting "SUBPARTS B AND C".

(3) Subparagraph (A) of section 1291(a)(3) is amended to read as follows:

"(A) HOLDING PERIOD.—The taxpayer's holding period shall be determined under section 1223; except that—

"(i) for purposes of applying this section to an excess distribution, such holding period shall be treated as ending on the date of such distribution, and

"(ii) if section 1296 applied to such stock with respect to the taxpayer for any prior taxable year, such holding period shall be treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 so applied.".

(c) TREATMENT OF MARK-TO-MARKET GAIN UNDER SECTION 4982.—

(1) Subsection (e) of section 4982 is amended by adding at the end thereof the following new paragraph:

"(6) TREATMENT OF GAIN RECOGNIZED UNDER SECTION 1296.—For purposes of determining a regulated investment company's ordinary income—

"(A) notwithstanding paragraph (1)(C), section 1296 shall be applied as if such company's taxable year ended on October 31, and

"(B) any ordinary gain or loss from an actual disposition of stock in a passive foreign investment company during the portion of the calendar year after October 31 shall be taken into account in determining such regulated investment company's ordinary income for the following calendar year.

In the case of a company making an election under paragraph (4), the preceding sentence shall be applied by substituting the last day of the company's taxable year for October 31.".

(2) Subsection (b) of section 852 is amended by adding at the end thereof the following new paragraph:

"(10) SPECIAL RULE FOR CERTAIN LOSSES ON STOCK IN PASSIVE FOREIGN INVESTMENT COMPANY.—To the extent provided in regulations, the taxable income of a regulated investment company (other than a company to which an election under section 4982(e)(4) applies) shall be computed without regard to any net reduction in the value of any stock of a passive foreign investment company with respect to which an election under section 1296(k) is in effect occurring after October 31 of the taxable year, and any such reduction shall be treated as occurring on the first day of the following taxable year.".

(3) Subsection (c) of section 852 is amended by inserting after "October 31 of such year" the following: ", without regard to any net reduction in the value of any stock of a passive foreign investment company with respect to which an election

under section 1296(k) is in effect occurring after October 31 of such year,”.

(d) CONFORMING AMENDMENTS.—

(1) Sections 532(b)(4) and 542(c)(10) are each amended by striking “section 1296” and inserting “section 1297”.

(2) Subsection (f) of section 551 is amended by striking “section 1297(b)(5)” and inserting “section 1298(b)(5)”.

(3) Subsections (a)(1) and (d) of section 1293 are each amended by striking “section 1297(a)” and inserting “section 1298(a)”.

(4) Paragraph (3) of section 1297(b), as redesignated by subsection (a), is hereby repealed.

(5) The table of sections for subpart D of part VI of subchapter P of chapter 1, as redesignated by subsection (a), is amended to read as follows:

“Sec. 1297. Passive foreign investment company.
“Sec. 1298. Special rules.”.

(6) The table of subparts for part VI of subchapter P of chapter 1 is amended by striking the last item and inserting the following new items:

“Subpart C. Election of mark to market for marketable stock.
“Subpart D. General provisions.”.

(e) CLARIFICATION OF GAIN RECOGNITION ELECTION.—The last sentence of section 1298(b)(1), as so redesignated, is amended by inserting “(determined without regard to the preceding sentence)” after “investment company”.

SEC. 1123. VALUATION OF ASSETS FOR PASSIVE FOREIGN INVESTMENT COMPANY DETERMINATION.

(a) IN GENERAL.—Section 1297, as redesignated by section 1122, is amended by adding at the end the following new subsection:

“(e) METHODS FOR MEASURING ASSETS.—

“(1) DETERMINATION USING VALUE.—The determination under subsection (a)(2) shall be made on the basis of the value of the assets of a foreign corporation if—

“(A) such corporation is a publicly traded corporation for the taxable year, or

“(B) paragraph (2) does not apply to such corporation for the taxable year.

“(2) DETERMINATION USING ADJUSTED BASES.—The determination under subsection (a)(2) shall be based on the adjusted bases (as determined for the purposes of computing earnings and profits) of the assets of a foreign corporation if such corporation is not described in paragraph (1)(A) and such corporation—

“(A) is a controlled foreign corporation, or

“(B) elects the application of this paragraph.

An election under subparagraph (B), once made, may be revoked only with the consent of the Secretary.

“(3) PUBLICLY TRADED CORPORATION.—For purposes of this subsection, a foreign corporation shall be treated as a publicly traded corporation if the stock in the corporation is regularly traded on—

"(A) a national securities exchange which is registered with the Securities and Exchange Commission or the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or

"(B) any exchange or other market which the Secretary determines has rules adequate to carry out the purposes of this subsection."

(b) CONFORMING AMENDMENTS.—Section 1297(a), as redesignated by section 1122, is amended—

(1) by striking "(by value)" and inserting "(as determined in accordance with subsection (e))", and

(2) by striking the last two sentences.

SEC. 1124. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to—

(1) taxable years of United States persons beginning after December 31, 1997, and

(2) taxable years of foreign corporations ending with or within such taxable years of United States persons.

Subtitle D—Repeal of Excise Tax on Transfers to Foreign Entities

SEC. 1131. REPEAL OF EXCISE TAX ON TRANSFERS TO FOREIGN ENTITIES; RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO FOREIGN TRUSTS AND ESTATES.

(a) REPEAL OF EXCISE TAX.—Chapter 5 (relating to transfers to avoid income tax) is hereby repealed.

(b) RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO FOREIGN TRUSTS AND ESTATES.—Subpart F of part I of subchapter J of chapter 1 is amended by adding at the end the following new section:

"SEC. 684. RECOGNITION OF GAIN ON CERTAIN TRANSFERS TO CERTAIN FOREIGN TRUSTS AND ESTATES.

"(a) IN GENERAL.—Except as provided in regulations, in the case of any transfer of property by a United States person to a foreign estate or trust, for purposes of this subtitle, such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

"(1) the fair market value of the property so transferred, over

"(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

"(b) EXCEPTION.—Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any person is treated as the owner of such trust under section 671.

"(c) TREATMENT OF TRUSTS WHICH BECOME FOREIGN TRUSTS.—If a trust which is not a foreign trust becomes a foreign trust, such trust shall be treated for purposes of this section as having transferred, immediately before becoming a foreign trust, all of its assets to a foreign trust.".

(b) OTHER ANTI-AVOIDANCE PROVISIONS REPLACING REPEALED EXCISE TAX.—

(1) GAIN RECOGNITION ON EXCHANGES INVOLVING FOREIGN PERSONS.—Section 1035 is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) EXCHANGES INVOLVING FOREIGN PERSONS.—To the extent provided in regulations, subsection (a) shall not apply to any exchange having the effect of transferring property to any person other than a United States person.".

(2) TRANSFERS TO FOREIGN CORPORATIONS.—Section 367 is amended by adding at the end the following new subsection:

"(f) OTHER TRANSFERS.—To the extent provided in regulations, if a United States person transfers property to a foreign corporation as paid-in surplus or as a contribution to capital (in a transaction not otherwise described in this section), such transfer shall be treated as a sale or exchange for an amount equal to the fair market value of the property transferred, and the transferor shall recognize as gain the excess of—

"(1) the fair market value of the property so transferred, over

"(2) the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.".

(3) CERTAIN TRANSFERS TO PARTNERSHIPS.—Section 721 is amended by adding at the end the following new subsection:

"(c) REGULATIONS RELATING TO CERTAIN TRANSFERS TO PARTNERSHIPS.—The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, will be includible in the gross income of a person other than a United States person.".

(4) REPEAL OF U.S. SOURCE TREATMENT OF DEEMED ROYALTIES.—Subparagraph (C) of section 367(d)(2) is amended to read as follows:

"(C) AMOUNTS RECEIVED TREATED AS ORDINARY INCOME.—For purposes of this chapter, any amount included in gross income by reason of this subsection shall be treated as ordinary income.".

(5) TRANSFERS OF INTANGIBLES TO PARTNERSHIPS.—

(A) Subsection (d) of section 367 is amended by adding at the end the following new paragraph:

"(3) REGULATIONS RELATING TO TRANSFERS OF INTANGIBLES TO PARTNERSHIPS.—The Secretary may provide by regulations that the rules of paragraph (2) also apply to the transfer of intangible property by a United States person to a partnership in circumstances consistent with the purposes of this subsection.".

(B) Section 721 is amended by adding at the end the following new subsection:

"(d) TRANSFERS OF INTANGIBLES.—

"For regulatory authority to treat intangibles transferred to a partnership as sold, see section 367(d)(3).".

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection (h) of section 814 is amended by striking "or 1491".

(2) Section 1057 (relating to election to treat transfer to foreign trust, etc., as taxable exchange) is hereby repealed.

(3) Section 6422 is amended by striking paragraph (5) and by redesignating paragraphs (6) through (13) as paragraphs (5) through (12), respectively.

(4) The table of chapters for subtitle A is amended by striking the item relating to chapter 5.

(5) The table of sections for part IV of subchapter O of chapter 1 is amended by striking the item relating to section 1057.

(6) The table of sections for subpart F of part I of subchapter J of chapter 1 is amended by adding at the end the following new item:

"Sec. 684. Recognition of gain on certain transfers to certain foreign trusts and estates.".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle E—Information Reporting

SEC. 1141. CLARIFICATION OF APPLICATION OF RETURN REQUIREMENT TO FOREIGN PARTNERSHIPS.

(a) IN GENERAL.—Section 6031 (relating to return of partnership income) is amended by adding at the end the following new subsection:

"(e) FOREIGN PARTNERSHIPS.—

"(1) EXCEPTION FOR FOREIGN PARTNERSHIP.—Except as provided in paragraph (2), the preceding provisions of this section shall not apply to a foreign partnership.

"(2) CERTAIN FOREIGN PARTNERSHIPS REQUIRED TO FILE RETURN.—Except as provided in regulations prescribed by the Secretary, this section shall apply to a foreign partnership for any taxable year if for such year, such partnership has—

"(A) gross income derived from sources within the United States, or

"(B) gross income which is effectively connected with the conduct of a trade or business within the United States.

The Secretary may provide simplified filing procedures for foreign partnerships to which this section applies.".

(b) SANCTION FOR FAILURE BY FOREIGN PARTNERSHIP TO COMPLY WITH SECTION 6031 TO INCLUDE DENIAL OF DEDUCTIONS.—Subsection (f) of section 6231 is amended—

(1) by striking "LOSSES AND" in the heading and inserting "DEDUCTIONS, LOSSES, AND", and

(2) by striking "loss or" each place it appears and inserting "deduction, loss, or".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1142. CONTROLLED FOREIGN PARTNERSHIPS SUBJECT TO INFORMATION REPORTING COMPARABLE TO INFORMATION REPORTING FOR CONTROLLED FOREIGN CORPORATIONS.

(a) IN GENERAL.—So much of section 6038 (relating to information with respect to certain foreign corporations) as precedes paragraph (2) of subsection (a) is amended to read as follows:

"SEC. 6038. INFORMATION REPORTING WITH RESPECT TO CERTAIN FOREIGN CORPORATIONS AND PARTNERSHIPS.

"(a) REQUIREMENT.—

"(1) IN GENERAL.—Every United States person shall furnish, with respect to any foreign business entity which such person controls, such information as the Secretary may prescribe relating to—

"(A) the name, the principal place of business, and the nature of business of such entity, and the country under whose laws such entity is incorporated (or organized in the case of a partnership);

"(B) in the case of a foreign corporation, its post-1986 undistributed earnings (as defined in section 902(c));

"(C) a balance sheet for such entity listing assets, liabilities, and capital;

"(D) transactions between such entity and—

"(i) such person,

"(ii) any corporation or partnership which such person controls, and

"(iii) any United States person owning, at the time the transaction takes place—

"(I) in the case of a foreign corporation, 10 percent or more of the value of any class of stock outstanding of such corporation, and

"(II) in the case of a foreign partnership, at least a 10-percent interest in such partnership; and

"(E)(i) in the case of a foreign corporation, 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

"(ii) information comparable to the information described in clause (i) in the case of a foreign partnership.

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.".

(b) DEFINITIONS.—

(1) IN GENERAL.—Subsection (e) of section 6038 (relating to definitions) is amended—

(A) by redesignating paragraphs (1) and (2) as paragraphs (2) and (4), respectively,

(B) by inserting before paragraph (2) (as so redesignated) the following new paragraph:

"(1) FOREIGN BUSINESS ENTITY.—The term 'foreign business entity' means a foreign corporation and a foreign partnership.", and

(C) by inserting after paragraph (2) (as so redesignated) the following new paragraph:

"(3) PARTNERSHIP-RELATED DEFINITIONS.—

"(A) CONTROL.—A person is in control of a partnership if such person owns directly or indirectly more than a 50 percent interest in such partnership.

"(B) 50-PERCENT INTEREST.—For purposes of subparagraph (A), a 50-percent interest in a partnership is—

"(i) an interest equal to 50 percent of the capital interest, or 50 percent of the profits interest, in such partnership, or

"(ii) to the extent provided in regulations, an interest to which 50 percent of the deductions or losses of such partnership are allocated.

For purposes of the preceding sentence, rules similar to the rules of section 267(c) (other than paragraph (3)) shall apply.

"(C) 10-PERCENT INTEREST.—A 10-percent interest in a partnership is an interest which would be described in subparagraph (B) if '10 percent' were substituted for '50 percent' each place it appears.".

(2) CLERICAL AMENDMENT.—The paragraph heading for paragraph (2) of section 6038(e) (as so redesignated) is amended by inserting "OF CORPORATION" after "CONTROL".

(c) MODIFICATION OF SANCTIONS ON PARTNERSHIPS AND CORPORATIONS FOR FAILURE TO FURNISH INFORMATION.—

(1) IN GENERAL.—Subsection (b) of section 6038 is amended—

(A) by striking "$1,000" each place it appears and inserting "$10,000", and

(B) by striking "$24,000" in paragraph (2) and inserting "$50,000".

(d) REPORTING BY 10-PERCENT PARTNERS.—Subsection (a) of section 6038 is amended by adding at the end the following new paragraph:

"(5) INFORMATION REQUIRED FROM 10-PERCENT PARTNER OF CONTROLLED FOREIGN PARTNERSHIP.—In the case of a foreign partnership which is controlled by United States persons holding at least 10-percent interests (but not by any one United States person), the Secretary may require each United States person who holds a 10-percent interest in such partnership to furnish information relating to such partnership, including information relating to such partner's ownership interests in the partnership and allocations to such partner of partnership items.".

(e) TECHNICAL AMENDMENTS.—

(1) The following provisions of section 6038 are each amended by striking "foreign corporation" each place it appears and inserting "foreign business entity":

(A) Paragraphs (2) and (3) of subsection (a).

(B) Subsection (b).

(C) Subsection (c) other than paragraph (1)(B) thereof.

(D) Subsection (d).

(E) Subsection (e)(4) (as redesignated by subsection (b)).

(2) Subparagraph (B) of section 6038(c)(1) is amended by inserting "in the case of a foreign business entity which is a foreign corporation," after "(B)".

(3) Paragraph (8) of section 318(b) is amended by striking "6038(d)(1)" and inserting "6038(d)(2)".

(4) Paragraph (4) of section 901(k) is amended by striking "foreign corporation" and inserting "foreign corporation or partnership".

(5) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking the item relating to section 6038 and inserting the following new item:

"Sec. 6038. Information reporting with respect to certain foreign corporations and partnerships.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to annual accounting periods beginning after the date of the enactment of this Act.

SEC. 1143. MODIFICATIONS RELATING TO RETURNS REQUIRED TO BE FILED BY REASON OF CHANGES IN OWNERSHIP INTERESTS IN FOREIGN PARTNERSHIP.

(a) NO RETURN REQUIRED UNLESS CHANGES INVOLVE 10-PERCENT INTEREST IN PARTNERSHIP.—

(1) IN GENERAL.—Subsection (a) of section 6046A (relating to returns as to interests in foreign partnerships) is amended by adding at the end the following new sentence: "Paragraphs (1) and (2) shall apply to any acquisition or disposition only if the United States person directly or indirectly holds at least a 10-percent interest in such partnership either before or after such acquisition or disposition, and paragraph (3) shall apply to any change only if the change is equivalent to at least a 10-percent interest in such partnership.".

(2) 10-PERCENT INTEREST.—Section 6046A is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) 10-PERCENT INTEREST.—For purposes of subsection (a), a 10-percent interest in a partnership is an interest described in section 6038(e)(3)(C).".

(b) MODIFICATION OF PENALTY ON FAILURE TO REPORT CHANGES IN OWNERSHIP INTERESTS IN FOREIGN CORPORATIONS AND PARTNERSHIPS.—Subsection (a) of section 6679 (relating to failure to file returns, etc., with respect to foreign corporations or foreign partnerships) is amended to read as follows:

"(a) CIVIL PENALTY.—

"(1) IN GENERAL.—In addition to any criminal penalty provided by law, any person required to file a return under section 6035, 6046, or 6046A who fails to file such return at the time provided in such section, or who files a return which does not show the information required pursuant to such section, shall pay a penalty of $10,000, unless it is shown that such failure is due to reasonable cause.

"(2) INCREASE IN PENALTY WHERE FAILURE CONTINUES AFTER NOTIFICATION.—If any failure described in paragraph (1) continues for more than 90 days after the day on which the Secretary mails notice of such failure to the United States person, such person shall pay a penalty (in addition to the amount re-

quired under paragraph (1)) of $10,000 for each 30-day period (or fraction thereof) during which such failure continues after the expiration of such 90-day period. The increase in any penalty under this paragraph shall not exceed $50,000.

"(3) REDUCED PENALTY FOR RETURNS RELATING TO FOREIGN PERSONAL HOLDING COMPANIES.—In the case of a return required under section 6035, paragraph (1) shall be applied by substituting '$1,000' for '$10,000', and paragraph (2) shall not apply.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers and changes after the date of the enactment of this Act.

SEC. 1144. TRANSFERS OF PROPERTY TO FOREIGN PARTNERSHIPS SUBJECT TO INFORMATION REPORTING COMPARABLE TO INFORMATION REPORTING FOR SUCH TRANSFERS TO FOREIGN CORPORATIONS.

(a) IN GENERAL.—Paragraph (1) of section 6038B(a) (relating to notice of certain transfers to foreign corporations) is amended to read as follows:

"(1) transfers property to—

"(A) a foreign corporation in an exchange described in section 332, 351, 354, 355, 356, or 361, or

"(B) a foreign partnership in a contribution described in section 721 or in any other contribution described in regulations prescribed by the Secretary,".

(b) EXCEPTIONS.—Section 6038B is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) EXCEPTIONS FOR CERTAIN TRANSFERS TO FOREIGN PARTNERSHIPS; SPECIAL RULE.—

"(1) EXCEPTIONS.—Subsection (a)(1)(B) shall apply to a transfer by a United States person to a foreign partnership only if—

"(A) the United States person holds (immediately after the transfer) directly or indirectly at least a 10-percent interest (as defined in section 6046A(d)) in the partnership, or

"(B) the value of the property transferred (when added to the value of the property transferred by such person or any related person to such partnership or a related partnership during the 12-month period ending on the date of the transfer) exceeds $100,000.

For purposes of the preceding sentence, the value of any transferred property is its fair market value at the time of its transfer.

"(2) SPECIAL RULE.—If by reason of an adjustment under section 482 or otherwise, a contribution described in subsection (a)(1) is deemed to have been made, such contribution shall be treated for purposes of this section as having been made not earlier than the date specified by the Secretary.".

(c) MODIFICATION OF PENALTY APPLICABLE TO FOREIGN CORPORATIONS AND PARTNERSHIPS.—

(1) IN GENERAL.—Paragraph (1) of section 6038B(b) is amended by striking "equal to" and all that follows and insert-

ing "equal to 10 percent of the fair market value of the property at the time of the exchange (and, in the case of a contribution described in subsection (a)(1)(B), such person shall recognize gain as if the contributed property had been sold for such value at the time of such contribution).".

(2) LIMIT ON PENALTY.—Section 6038B(b) is amended by adding at the end the following new paragraph:

"(3) LIMIT ON PENALTY.—The penalty under paragraph (1) with respect to any exchange shall not exceed $100,000 unless the failure with respect to such exchange was due to intentional disregard.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to transfers made after the date of the enactment of this Act.

(2) ELECTION OF RETROACTIVE EFFECT.—Section 1494(c) of the Internal Revenue Code of 1986 shall not apply to any transfer after August 20, 1996, if all applicable reporting requirements under section 6038B of such Code (as amended by this section) are satisfied. The Secretary of the Treasury or his delegate may prescribe simplified reporting requirements under the preceding sentence.

SEC. 1145. EXTENSION OF STATUTE OF LIMITATIONS FOR FOREIGN TRANSFERS.

(a) IN GENERAL.—Paragraph (8) of section 6501(c) (relating to failure to notify Secretary under section 6038B) is amended to read as follows:

"(8) FAILURE TO NOTIFY SECRETARY OF CERTAIN FOREIGN TRANSFERS.—In the case of any information which is required to be reported to the Secretary under section 6038, 6038A, 6038B, 6046, 6046A, or 6048, the time for assessment of any tax imposed by this title with respect to any event or period to which such information relates shall not expire before the date which is 3 years after the date on which the Secretary is furnished the information required to be reported under such section.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to information the due date for the reporting of which is after the date of the enactment of this Act.

SEC. 1146. INCREASE IN FILING THRESHOLDS FOR RETURNS AS TO ORGANIZATION OF FOREIGN CORPORATIONS AND ACQUISITIONS OF STOCK IN SUCH CORPORATIONS.

(a) IN GENERAL.—Subsection (a) of section 6046 (relating to returns as to organization or reorganization of foreign corporations and as to acquisitions of their stock) is amended to read as follows:

"(a) REQUIREMENT OF RETURN.—

"(1) IN GENERAL.—A return complying with the requirements of subsection (b) shall be made by—

"(A) each United States citizen or resident who becomes an officer or director of a foreign corporation if a United States person (as defined in section 7701(a)(30)) meets the stock ownership requirements of paragraph (2) with respect to such corporation,

"(B) each United States person—

"(i) who acquires stock which, when added to any stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation, or

"(ii) who acquires stock which, without regard to stock owned on the date of such acquisition, meets the stock ownership requirements of paragraph (2) with respect to a foreign corporation,

"(C) each person (not described in subparagraph (B)) who is treated as a United States shareholder under section 953(c) with respect to a foreign corporation, and

"(D) each person who becomes a United States person while meeting the stock ownership requirements of paragraph (2) with respect to stock of a foreign corporation.

In the case of a foreign corporation with respect to which any person is treated as a United States shareholder under section 953(c), subparagraph (A) shall be treated as including a reference to each United States person who is an officer or director of such corporation.

"(2) STOCK OWNERSHIP REQUIREMENTS.—A person meets the stock ownership requirements of this paragraph with respect to any corporation if such person owns 10 percent or more of—

"(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(B) the total value of the stock of such corporation.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on January 1, 1998.

Subtitle F—Determination of Foreign or Domestic Status of Partnerships

SEC. 1151. DETERMINATION OF FOREIGN OR DOMESTIC STATUS OF PARTNERSHIPS.

(a) IN GENERAL.—Paragraph (4) of section 7701(a) is amended by inserting before the period "unless, in the case of a partnership, the Secretary provides otherwise by regulations".

(b) EFFECTIVE DATE.—Any regulations issued with respect to the amendment made by subsection (a) shall apply to partnerships created or organized after the date determined under section 7805(b) of the Internal Revenue Code of 1986 (without regard to paragraph (2) thereof) with respect to such regulations.

Subtitle G—Other Simplification Provisions

SEC. 1161. TRANSITION RULE FOR CERTAIN TRUSTS.

(a) IN GENERAL.—Paragraph (3) of section 1907(a) of the Small Business Job Protection Act of 1996 is amended by adding at the end the following flush sentence:

"To the extent prescribed in regulations by the Secretary of the Treasury or his delegate, a trust which was in existence on August 20, 1996 (other than a trust treated as owned by the grant-

or under subpart E of part I of subchapter J of chapter 1 of the Internal Revenue Code of 1986), and which was treated as a United States person on the day before the date of the enactment of this Act may elect to continue to be treated as a United States person notwithstanding section 7701(a)(30)(E) of such Code.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the amendments made by section 1907(a) of the Small Business Job Protection Act of 1996.

SEC. 1162. REPEAL OF STOCK AND SECURITIES SAFE HARBOR REQUIREMENT THAT PRINCIPAL OFFICE BE OUTSIDE THE UNITED STATES.

(a) IN GENERAL.—The last sentence of clause (ii) of section 864(b)(2)(A) (relating to stock or securities) is amended by striking ", or in the case of a corporation" and all that follows and inserting a period.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 1163. MISCELLANEOUS CLARIFICATIONS.

(a) ATTRIBUTION OF DEEMED PAID FOREIGN TAXES TO PRIOR DISTRIBUTIONS.—Subparagraph (B) of section 902(c)(2) is amended by striking "deemed paid with respect to" and inserting "attributable to".

(b) FINANCIAL SERVICES INCOME DETERMINED WITHOUT REGARD TO HIGH-TAXED INCOME.—Subclause (II) of section 904(d)(2)(C)(i) is amended by striking "subclause (I)" and inserting "subclauses (I) and (III)".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle H—Other Provisions

SEC. 1171. TREATMENT OF COMPUTER SOFTWARE AS FSC EXPORT PROPERTY.

(a) IN GENERAL.—Subparagraph (B) of section 927(a)(2) (relating to property excluded from eligibility as FSC export property) is amended by inserting ", and other than computer software (whether or not patented)" before ", for commercial or home use".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to gross receipts attributable to periods after December 31, 1997, in taxable years ending after such date.

SEC. 1172. ADJUSTMENT OF DOLLAR LIMITATION ON SECTION 911 EXCLUSION.

(a) GENERAL RULE.—Paragraph (2) of section 911(b) is amended by—

(1) by striking "of $70,000" in subparagraph (A) and inserting "equal to the exclusion amount for the calendar year in which such taxable year begins", and

(2) by adding at the end the following new subparagraph:

"(D) EXCLUSION AMOUNT.—

"(i) IN GENERAL.—The exclusion amount for any calendar year is the exclusion amount determined in

accordance with the following table (as adjusted by clause (ii)):

"For calendar year—	*The exclusion amount is—*
1998	*$72,000*
1999	*74,000*
2000	*76,000*
2001	*78,000*
2002 and thereafter	*80,000.*

"(ii) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2007, the $80,000 amount in clause (i) shall be increased by an amount equal to the product of—

"(I) such dollar amount, and

"(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting '2006' for '1992' in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $100, such increase shall be rounded to the next lowest multiple of $100.".

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

SEC. 1173. UNITED STATES PROPERTY NOT TO INCLUDE CERTAIN ASSETS ACQUIRED BY DEALERS IN ORDINARY COURSE OF TRADE OR BUSINESS.

(a) IN GENERAL.—Section 956(c)(2) is amended by striking "and" at the end of subparagraph (H), by striking the period at the end of subparagraph (I) and inserting a semicolon, and by adding at the end the following new subparagraphs:

"(J) deposits of cash or securities made or received on commercial terms in the ordinary course of a United States or foreign person's business as a dealer in securities or in commodities, but only to the extent such deposits are made or received as collateral or margin for (i) a securities loan, notional principal contract, options contract, forward contract, or futures contract, or (ii) any other financial transaction in which the Secretary determines that it is customary to post collateral or margin; and

"(K) an obligation of a United States person to the extent the principal amount of the obligation does not exceed the fair market value of readily marketable securities sold or purchased pursuant to a sale and repurchase agreement or otherwise posted or received as collateral for the obligation in the ordinary course of its business by a United States or foreign person which is a dealer in securities or commodities.

For purposes of subparagraphs (J) and (K), the term 'dealer in securities' has the meaning given such term by section 475(c)(1), and the term 'dealer in commodities' has the meaning given such term by section 475(e), except that such term shall include a futures commission merchant.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 1997, and to taxable years of United States sharehold-

ers with or within which such taxable years of foreign corporations end.

SEC. 1174. TREATMENT OF NONRESIDENT ALIENS ENGAGED IN INTERNATIONAL TRANSPORTATION SERVICES.

(a) SOURCING RULES.—

(1) IN GENERAL.—Section 861(a)(3) is amended by adding at the end the following new flush sentence:

"In addition, except for purposes of sections 79 and 105 and subchapter D, compensation for labor or services performed in the United States shall not be deemed to be income from sources within the United States if the labor or services are performed by a nonresident alien individual in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States.".

(2) TRANSPORTATION INCOME.—Subparagraph (B) of section 863(c)(2) is amended by adding at the end the following flush sentence:

"In the case of transportation income derived from, or in connection with, a vessel, this subparagraph shall only apply if the taxpayer is a citizen or resident alien.".

(b) PRESENCE IN UNITED STATES.—

(1) IN GENERAL.—Paragraph (7) of section 7701(b) is amended by adding at the end the following new subparagraph:

"(D) CREW MEMBERS TEMPORARILY PRESENT.—An individual who is temporarily present in the United States on any day as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States shall not be treated as present in the United States on such day unless such individual otherwise engages in any trade or business in the United States on such day.".

(2) CONFORMING AMENDMENT.—Subparagraph (A) of section 7701(b)(7) is amended by striking "or (C)" and inserting ", (C), or (D)".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to remuneration for services performed in taxable years beginning after December 31, 1997.

(2) PRESENCE.—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1997.

SEC. 1175. EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) EXEMPTION FROM FOREIGN PERSONAL HOLDING COMPANY INCOME.—Section 954 is amended by adding at the end the following new subsection:

"(h) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF BANKING, FINANCING, OR SIMILAR BUSINESSES.—

"(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include income which is—

"(A) derived in the active conduct by a controlled foreign corporation of a banking, financing, or similar busi-

ness, but only if the corporation is predominantly engaged in the active conduct of such business,

"(B) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from the investments made by a qualifying insurance company of its reserves or of 80 percent of its unearned premiums (as both are determined in the manner prescribed under paragraph (4)), or

"(C) received from a person other than a related person (within the meaning of subsection (d)(3)) and derived from investments made by a qualifying insurance company of an amount of its assets equal to—

"(i) in the case of contracts regulated in the country in which sold as property, casualty, or health insurance contracts, one-third of its premiums earned on such insurance contracts during the taxable year (as defined in section 832(b)(4)), and

"(ii) in the case of contracts regulated in the country in which sold as life insurance or annuity contracts, the greater of—

"(I) 10 percent of the reserves described in subparagraph (B) for such contracts, or

"(II) in the case of a qualifying insurance company which is a start-up company, $10,000,000.

"(2) PRINCIPLES FOR DETERMINING APPLICABLE INCOME.—

"(A) BANKING AND FINANCING INCOME.—The determination as to whether income is described in paragraph (1)(A) shall be made—

"(i) except as provided in clause (ii), in accordance with the applicable principles of section 904(d)(2)(C)(ii), except that such income shall include income from all leases entered into in the ordinary course of the active conduct of a banking, financing, or similar business, and

"(ii) in the case of a corporation described in paragraph (3)(B), in accordance with the applicable principles of section 1296(b) (as in effect on the day before the enactment of the Taxpayer Relief Act of 1997) for determining what is not passive income.

"(B) INSURANCE INCOME.—Under rules prescribed by the Secretary, for purposes of paragraphs (1) (B) and (C)—

"(i) in the case of contracts which are separate account-type contracts (including variable contracts not meeting the requirements of section 817), only income specifically allocable to such contracts shall be taken into account, and

"(ii) in the case of other contracts, income not allocable under clause (i) shall be allocated ratably among such contracts.

"(C) LOOK-THRU RULES.—The Secretary shall prescribe regulations consistent with the principles of section 904(d)(3) which provide that dividends, interest, income equivalent to interest, rents, or royalties received or accrued from a related person (within the meaning of subsection

(d)(3)) shall be subject to look-thru treatment for purposes of this subsection.

"(3) PREDOMINANTLY ENGAGED.—For purposes of paragraph (1)(A), a corporation shall be deemed predominantly engaged in the active conduct of a banking, financing, or similar business only if—

"(A) more than 70 percent of its gross income is derived from such business from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located within the country under the laws of which the controlled foreign corporation is created or organized, or

"(B) the corporation is—

"(i) engaged in the active conduct of a banking or securities business (within the meaning of section 1296(b), as in effect before the enactment of the Taxpayer Relief Act of 1997), or

"(ii) a qualified bank affiliate or a qualified securities affiliate (within the meaning of the proposed regulations under such section 1296(b)).

"(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (1)(B)—

"(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company with respect to property, casualty, or health insurance contracts shall be determined using the same methods and interest rates which would be used if such company were subject to tax under subchapter L.

"(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—The reserves of a qualifying insurance company with respect to life insurance or annuity contracts shall be determined under the method described in paragraph (5) which such company elects to apply for purposes of this paragraph. Such election shall be made at such time and in such manner as the Secretary may prescribe and, once made, shall be irrevocable without the consent of the Secretary.

"(C) LIMITATION ON RESERVES.—In no event shall the reserve determined under this paragraph for any contract as of any time exceed the amount which would be taken into account with respect to such contract as of such time in determining foreign annual statement reserves (less any catastrophe or deficiency reserves).

"(5) METHODS.—The methods described in this paragraph are as follows:

"(A) U.S. METHOD.—The method which would apply if the qualifying insurance company were subject to tax under subchapter L, except that the interest rate used shall be an interest rate determined for the foreign country in which such company is created or organized and which is calculated in the same manner as the Federal mid-term rate under section 1274(d).

"(B) FOREIGN METHOD.—A preliminary term method, except that the interest rate used shall be the interest rate determined for the foreign country in which such company

is created or organized and which is calculated in the same manner as the Federal mid-term rate under section 1274(d). If a qualifying insurance company uses such a preliminary term method with respect to contracts insuring risks located in such foreign country, such method shall apply if such company elects the method under this clause.

"(C) CASH SURRENDER VALUE.—A method under which reserves are equal to the net surrender value (as defined in section 807(e)(1)(A)) of the contract.

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

"(A) TERMS RELATING TO INSURANCE COMPANIES.—

"(i) QUALIFYING INSURANCE COMPANY.—The term 'qualifying insurance company' means any entity which—

"(I) is subject to regulation as an insurance company under the laws of its country of incorporation,

"(II) realizes at least 50 percent of its net written premiums from the insurance or reinsurance of risks located within the country in which such entity is created or organized, and

"(III) is engaged in the active conduct of an insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

"(ii) START-UP COMPANY.—A qualifying insurance company shall be treated as a start-up company if such company (and any predecessor) has not been engaged in the active conduct of an insurance business for more than 5 years as of the beginning of the taxable year of such company.

"(B) LOCATED.—For purposes of paragraph (3)(A)—

"(i) IN GENERAL.—A person shall be treated as located—

"(I) except as provided in subclause (II), within the country in which it maintains an office or other fixed place of business through which it engages in a trade or business and by which the transaction is effected, or

"(II) in the case of a natural person, within the country in which such person is physically located when such person enters into a transaction.

"(ii) SPECIAL RULE FOR QUALIFIED BUSINESS UNITS.—Gross income derived by a corporation's qualified business unit (within the meaning of section 989(a)) from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located in the country in which the qualified business unit both maintains its principal office and conducts substantial business activity shall be treated as derived from transactions with persons which are not related persons (as defined in subsection (d)(3)) and which are located within the country under the

laws of which the controlled foreign corporation is created or organized.

"(7) ANTI-ABUSE RULES.—For purposes of applying this subsection, there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions one of the principal purposes of which is qualifying income or gain for the exclusion under this section, including any change in the method of computing reserves or any other transaction or series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of such exclusion through the application of this subsection.

"(8) COORDINATION WITH SECTION 953.—This subsection shall not apply to investment income allocable to contracts that insure related party risks or risks located in a foreign country other than the country in which the qualifying insurance comapny is created or organized.

"(9) APPLICATION.—This subsection shall apply to the first full taxable year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.".

(b) EXEMPTION FROM FOREIGN BASE COMPANY SERVICES INCOME.—Paragraph (2) of section 954(e) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end the following:

"(C) in the case of taxable years described in subsection (h)(8), the active conduct by a controlled foreign corporation of a banking, financing, insurance, or similar business, but only if the corporation is predominantly engaged in the active conduct of such business (within the meaning of subsection (h)(3)) or is a qualifying insurance company.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to the first full taxable year of a foreign corporation beginning after December 31, 1997, and before January 1, 1999, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.

TITLE XII—SIMPLIFICATION PROVISIONS RELATING TO INDIVIDUALS AND BUSINESSES

Subtitle A—Provisions Relating to Individuals

SEC. 1201. BASIC STANDARD DEDUCTION AND MINIMUM TAX EXEMPTION AMOUNT FOR CERTAIN DEPENDENTS.

(a) BASIC STANDARD DEDUCTION.—

(1) IN GENERAL.—Paragraph (5) of section 63(c) (relating to limitation on basic standard deduction in the case of certain de-

pendents) is amended by striking "shall not exceed" and all that follows and inserting "shall not exceed the greater of—

"(A) $500, or

"(B) the sum of $250 and such individual's earned income.".

(2) CONFORMING AMENDMENT.—Paragraph (4) of section 63(c) is amended—

(A) by striking "(5)(A)" in the material preceding subparagraph (A) and inserting "(5)", and

(B) by striking "by substituting" and all that follows in subparagraph (B) and inserting "by substituting for 'calendar year 1992' in subparagraph (B) thereof—

"(i) 'calendar year 1987' in the case of the dollar amounts contained in paragraph (2) or (5)(A) or subsection (f), and

"(ii) 'calendar year 1997' in the case of the dollar amount contained in paragraph (5)(B).".

(b) MINIMUM TAX EXEMPTION AMOUNT.—

(1) IN GENERAL.—Subsection (j) of section 59 is amended to read as follows:

"(j) TREATMENT OF UNEARNED INCOME OF MINOR CHILDREN.—

"(1) IN GENERAL.—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) $5,000.

"(2) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 1998, the dollar amount in paragraph (1)(B) shall be increased by an amount equal to the product of—

"(A) such dollar amount, and

"(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 '1997' for '1992' in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $50, such increase shall be rounded to the nearest multiple of $50.".

(2) CONFORMING AMENDMENT.—Clause (iv) of section 6103(e)(1)(A) is amended by striking "or 59(j)".

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

SEC. 1202. INCREASE IN AMOUNT OF TAX EXEMPT FROM ESTIMATED TAX REQUIREMENTS.

(a) IN GENERAL.—Paragraph (1) of section 6654(e) (relating to exception where tax is small amount) is amended by striking "$500" and inserting "$1,000".

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

SEC. 1203. TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.

(a) IN GENERAL.—Section 162 (relating to trade or business expenses) is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) TREATMENT OF CERTAIN REIMBURSED EXPENSES OF RURAL MAIL CARRIERS.—

"(1) GENERAL RULE.—In the case of any employee of the United States Postal Service who performs services involving the collection and delivery of mail on a rural route and who receives qualified reimbursements for the expenses incurred by such employee for the use of a vehicle in performing such services—

"(A) the amount allowable as a deduction under this chapter for the use of a vehicle in performing such services shall be equal to the amount of such qualified reimbursements; and

"(B) such qualified reimbursements shall be treated as paid under a reimbursement or other expense allowance arrangement for purposes of section 62(a)(2)(A) (and section 62(c) shall not apply to such qualified reimbursements).

"(2) DEFINITION OF QUALIFIED REIMBURSEMENTS.—For purposes of this subsection, the term 'qualified reimbursements' means the amounts paid by the United States Postal Service to employees as an equipment maintenance allowance under the 1991 collective bargaining agreement between the United States Postal Service and the National Rural Letter Carriers' Association. Amounts paid as an equipment maintenance allowance by such Postal Service under later collective bargaining agreements that supersede the 1991 agreement shall be considered qualified reimbursements if such amounts do not exceed the amounts that would have been paid under the 1991 agreement, adjusted for changes in the Consumer Price Index (as defined in section 1(f)(5)) since 1991.".

(b) TECHNICAL AMENDMENT.—Section 6008 of the Technical and Miscellaneous Revenue Act of 1988 is hereby repealed.

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

SEC. 1204. TREATMENT OF TRAVELING EXPENSES OF CERTAIN FEDERAL EMPLOYEES ENGAGED IN CRIMINAL INVESTIGATIONS.

(a) IN GENERAL.—Subsection (a) of section 162 is amended by adding at the end the following new sentence: "The preceding sentence shall not apply to any Federal employee during any period for which such employee is certified by the Attorney General (or the designee thereof) as traveling on behalf of the United States in temporary duty status to investigate, or provide support services for the investigation of, a Federal crime.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to amounts paid or incurred with respect to taxable years ending after the date of the enactment of this Act.

SEC. 1205. PAYMENT OF TAX BY COMMERCIALLY ACCEPTABLE MEANS.

(a) GENERAL RULE.—Section 6311 is amended to read as follows:

"SEC. 6311. PAYMENT OF TAX BY COMMERCIALLY ACCEPTABLE MEANS.

"(a) AUTHORITY TO RECEIVE.—It shall be lawful for the Secretary to receive for internal revenue taxes (or in payment for internal revenue stamps) any commercially acceptable means that the Secretary deems appropriate to the extent and under the conditions provided in regulations prescribed by the Secretary.

"(b) ULTIMATE LIABILITY.—If a check, money order, or other method of payment, including payment by credit card, debit card, or charge card so received is not duly paid, or is paid and subsequently charged back to the Secretary, the person by whom such check, or money order, or other method of payment has been tendered shall remain liable for the payment of the tax or for the stamps, and for all legal penalties and additions, to the same extent as if such check, money order, or other method of payment had not been tendered.

"(c) LIABILITY OF BANKS AND OTHERS.—If any certified, treasurer's, or cashier's check (or other guaranteed draft), or any money order, or any other means of payment that has been guaranteed by a financial institution (such as a credit card, debit card, or charge card transaction which has been guaranteed expressly by a financial institution) so received is not duly paid, the United States shall, in addition to its right to exact payment from the party originally indebted therefor, have a lien for—

"(1) the amount of such check (or draft) upon all assets of the financial institution on which drawn,

"(2) the amount of such money order upon all the assets of the issuer thereof, or

"(3) the guaranteed amount of any other transaction upon all the assets of the institution making such guarantee,

and such amount shall be paid out of such assets in preference to any other claims whatsoever against such financial institution, issuer, or guaranteeing institution, except the necessary costs and expenses of administration and the reimbursement of the United States for the amount expended in the redemption of the circulating notes of such financial institution.

"(d) PAYMENT BY OTHER MEANS.—

"(1) AUTHORITY TO PRESCRIBE REGULATIONS.—The Secretary shall prescribe such regulations as the Secretary deems necessary to receive payment by commercially acceptable means, including regulations that—

"(A) specify which methods of payment by commercially acceptable means will be acceptable,

"(B) specify when payment by such means will be considered received,

"(C) identify types of nontax matters related to payment by such means that are to be resolved by persons ultimately liable for payment and financial intermediaries, without the involvement of the Secretary, and

"(D) ensure that tax matters will be resolved by the Secretary, without the involvement of financial intermediaries.

"(2) AUTHORITY TO ENTER INTO CONTRACTS.—Notwithstanding section 3718(f) of title 31, United States Code, the Secretary is authorized to enter into contracts to obtain services re-

lated to receiving payment by other means where cost beneficial to the Government. The Secretary may not pay any fee or provide any other consideration under such contracts.

"(3) SPECIAL PROVISIONS FOR USE OF CREDIT CARDS.—If use of credit cards is accepted as a method of payment of taxes pursuant to subsection (a)—

"(A) a payment of internal revenue taxes (or a payment for internal revenue stamps) by a person by use of a credit card shall not be subject to section 161 of the Truth in Lending Act (15 U.S.C. 1666), or to any similar provisions of State law, if the error alleged by the person is an error relating to the underlying tax liability, rather than an error relating to the credit card account such as a computational error or numerical transposition in the credit card transaction or an issue as to whether the person authorized payment by use of the credit card,

"(B) a payment of internal revenue taxes (or a payment for internal revenue stamps) shall not be subject to section 170 of the Truth in Lending Act (15 U.S.C. 1666i), or to any similar provisions of State law,

"(C) a payment of internal revenue taxes (or a payment for internal revenue stamps) by a person by use of a debit card shall not be subject to section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), or to any similar provisions of State law, if the error alleged by the person is an error relating to the underlying tax liability, rather than an error relating to the debit card account such as a computational error or numerical transposition in the debit card transaction or an issue as to whether the person authorized payment by use of the debit card,

"(D) the term 'creditor' under section 103(f) of the Truth in Lending Act (15 U.S.C. 1602(f)) shall not include the Secretary with respect to credit card transactions in payment of internal revenue taxes (or payment for internal revenue stamps), and

"(E) notwithstanding any other provision of law to the contrary, in the case of payment made by credit card or debit card transaction of an amount owed to a person as the result of the correction of an error under section 161 of the Truth in Lending Act (15 U.S.C. 1666) or section 908 of the Electronic Fund Transfer Act (15 U.S.C. 1693f), the Secretary is authorized to provide such amount to such person as a credit to that person's credit card or debit card account through the applicable credit card or debit card system.

"(e) CONFIDENTIALITY OF INFORMATION.—

"(1) IN GENERAL.—Except as otherwise authorized by this subsection, no person may use or disclose any information relating to credit or debit card transactions obtained pursuant to section 6103(k)(8) other than for purposes directly related to the processing of such transactions, or the billing or collection of amounts charged or debited pursuant thereto.

"(2) EXCEPTIONS.—

"(A) Debit or credit card issuers or others acting on behalf of such issuers may also use and disclose such information for purposes directly related to servicing an issuer's accounts.

"(B) Debit or credit card issuers or others directly involved in the processing of credit or debit card transactions or the billing or collection of amounts charged or debited thereto may also use and disclose such information for purposes directly related to—

"(i) statistical risk and profitability assessment;

"(ii) transferring receivables, accounts, or interest therein;

"(iii) auditing the account information;

"(iv) complying with Federal, State, or local law; and

"(v) properly authorized civil, criminal, or regulatory investigation by Federal, State, or local authorities.

"(3) PROCEDURES.—Use and disclosure of information under this paragraph shall be made only to the extent authorized by written procedures promulgated by the Secretary.

"(4) CROSS REFERENCE.—

"For provision providing for civil damages for violation of paragraph (1), see section 7431.".

(b) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 64 is amended by striking the item relating to section 6311 and inserting the following:

"Sec. 6311. Payment of tax by commercially acceptable means.".

(c) AMENDMENTS TO SECTIONS 6103 AND 7431 WITH RESPECT TO DISCLOSURE AUTHORIZATION.—

(1) Subsection (k) of section 6103 (relating to confidentiality and disclosure of returns and return information) is amended by adding at the end the following new paragraph:

"(8) DISCLOSURE OF INFORMATION TO ADMINISTER SECTION 6311.—The Secretary may disclose returns or return information to financial institutions and others to the extent the Secretary deems necessary for the administration of section 6311. Disclosures of information for purposes other than to accept payments by checks or money orders shall be made only to the extent authorized by written procedures promulgated by the Secretary.".

(2) Section 7431 (relating to civil damages for unauthorized disclosure of returns and return information) is amended by adding at the end the following new subsection:

"(g) SPECIAL RULE FOR INFORMATION OBTAINED UNDER SECTION 6103(k)(8).—For purposes of this section, any reference to section 6103 shall be treated as including a reference to section 6311(e).".

(3) Section 6103(p)(3)(A) is amended by striking "or (6)" and inserting "(6), or (8)".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the day 9 months after the date of the enactment of this Act.

Subtitle B—Provisions Relating to Businesses Generally

SEC. 1211. MODIFICATIONS TO LOOK-BACK METHOD FOR LONG-TERM CONTRACTS.

(a) LOOK-BACK METHOD NOT TO APPLY IN CERTAIN CASES.—Subsection (b) of section 460 (relating to percentage of completion method) is amended by adding at the end the following new paragraph:

"(6) ELECTION TO HAVE LOOK-BACK METHOD NOT APPLY IN DE MINIMIS CASES.—

"(A) AMOUNTS TAKEN INTO ACCOUNT AFTER COMPLETION OF CONTRACT.—Paragraph (1)(B) shall not apply with respect to any taxable year (beginning after the taxable year in which the contract is completed) if—

"(i) the cumulative taxable income (or loss) under the contract as of the close of such taxable year, is within

"(ii) 10 percent of the cumulative look-back taxable income (or loss) under the contract as of the close of the most recent taxable year to which paragraph (1)(B) applied (or would have applied but for subparagraph (B)).

"(B) DE MINIMIS DISCREPANCIES.—Paragraph (1)(B) shall not apply in any case to which it would otherwise apply if—

"(i) the cumulative taxable income (or loss) under the contract as of the close of each prior contract year, is within

"(ii) 10 percent of the cumulative look-back income (or loss) under the contract as of the close of such prior contract year.

"(C) DEFINITIONS.—For purposes of this paragraph—

"(i) CONTRACT YEAR.—The term 'contract year' means any taxable year for which income is taken into account under the contract.

"(ii) LOOK-BACK INCOME OR LOSS.—The look-back income (or loss) is the amount which would be the taxable income (or loss) under the contract if the allocation method set forth in paragraph (2)(A) were used in determining taxable income.

"(iii) DISCOUNTING NOT APPLICABLE.—The amounts taken into account after the completion of the contract shall be determined without regard to any discounting under the 2nd sentence of paragraph (2).

"(D) CONTRACTS TO WHICH PARAGRAPH APPLIES.—This paragraph shall only apply if the taxpayer makes an election under this subparagraph. Unless revoked with the consent of the Secretary, such an election shall apply to all long-term contracts completed during the taxable year for which election is made or during any subsequent taxable year.".

(b) MODIFICATION OF INTEREST RATE.—

(1) IN GENERAL.—Subparagraph (C) of section 460(b)(2) is amended by striking "the overpayment rate established by section 6621" and inserting "the adjusted overpayment rate (as defined in paragraph (7))".

(2) ADJUSTED OVERPAYMENT RATE.—Subsection (b) of section 460 is amended by adding at the end the following new paragraph:

"(7) ADJUSTED OVERPAYMENT RATE.—

"(A) IN GENERAL.—The adjusted overpayment rate for any interest accrual period is the overpayment rate in effect under section 6621 for the calendar quarter in which such interest accrual period begins.

"(B) INTEREST ACCRUAL PERIOD.—For purposes of subparagraph (A), the term 'interest accrual period' means the period—

"(i) beginning on the day after the return due date for any taxable year of the taxpayer, and

"(ii) ending on the return due date for the following taxable year.

For purposes of the preceding sentence, the term 'return due date' means the date prescribed for filing the return of the tax imposed by this chapter (determined without regard to extensions).".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contracts completed in taxable years ending after the date of the enactment of this Act.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply for purposes of section 167(g) of the Internal Revenue Code of 1986 to property placed in service after September 13, 1995.

SEC. 1212. MINIMUM TAX TREATMENT OF CERTAIN PROPERTY AND CASUALTY INSURANCE COMPANIES.

(a) IN GENERAL.—Clause (i) of section 56(g)(4)(B) (relating to inclusion of items included for purposes of computing earnings and profits) is amended by adding at the end the following new sentence: "In the case of any insurance company taxable under section 831(b), this clause shall not apply to any amount not described in section 834(b).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1997.

SEC. 1213. QUALIFIED LESSEE CONSTRUCTION ALLOWANCES FOR SHORT-TERM LEASES.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by inserting after section 109 the following new section:

"SEC. 110. QUALIFIED LESSEE CONSTRUCTION ALLOWANCES FOR SHORT-TERM LEASES.

"(a) IN GENERAL.—Gross income of a lessee does not include any amount received in cash (or treated as a rent reduction) by a lessee from a lessor—

"(1) under a short-term lease of retail space, and

"(2) for the purpose of such lessee's constructing or improving qualified long-term real property for use in such lessee's trade or business at such retail space,

but only to the extent that such amount does not exceed the amount expended by the lessee for such construction or improvement.

"(b) CONSISTENT TREATMENT BY LESSOR.—Qualified long-term real property constructed or improved in connection with any amount excluded from a lessee's income by reason of subsection (a) shall be treated as nonresidential real property of the lessor (including for purposes of section 168(i)(8)(B)).

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

"(1) QUALIFIED LONG-TERM REAL PROPERTY.—The term 'qualified long-term real property' means nonresidential real property which is part of, or otherwise present at, the retail space referred to in subsection (a) and which reverts to the lessor at the termination of the lease.

"(2) SHORT-TERM LEASE.—The term 'short-term lease' means a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined under the rules of section 168(i)(3)).

"(3) RETAIL SPACE.—The term 'retail space' means real property leased, occupied, or otherwise used by a lessee in its trade or business of selling tangible personal property or services to the general public.

"(d) INFORMATION REQUIRED TO BE FURNISHED TO SECRETARY.—Under regulations, the lessee and lessor described in subsection (a) shall, at such times and in such manner as may be provided in such regulations, furnish to the Secretary—

"(1) information concerning the amounts received (or treated as a rent reduction) and expended as described in subsection (a), and

"(2) any other information which the Secretary deems necessary to carry out the provisions of this section.".

(b) TREATMENT AS INFORMATION RETURN.—Subparagraph (A) of section 6724(d)(1)(A) is amended by striking "or" at the end of clause (vii), by adding "or" at the end of clause (viii), and by adding at the end the following new clause:

"(ix) section 110(d) (relating to qualified lessee construction allowances for short-term leases),".

(c) CROSS REFERENCE.—Paragraph (8) of section 168(i) (relating to treatment of leasehold improvements) is amended by adding at the end the following new subparagraph:

"(C) CROSS REFERENCE.—

"For treatment of qualified long-term real property constructed or improved in connection with cash or rent reduction from lessor to lessee, see section 110(b).".

(d) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 109 the following new item:

"Sec. 110. Qualified lessee construction allowances for short-term leases.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to leases entered into after the date of the enactment of this Act.

Subtitle C—Simplification Relating to Electing Large Partnerships

PART I—GENERAL PROVISIONS

SEC. 1221. SIMPLIFIED FLOW-THROUGH FOR ELECTING LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Subchapter K (relating to partners and partnerships) is amended by adding at the end the following new part:

"PART IV—SPECIAL RULES FOR ELECTING LARGE PARTNERSHIPS

"SEC. 771. APPLICATION OF SUBCHAPTER TO ELECTING LARGE PARTNERSHIPS.

"The preceding provisions of this subchapter to the extent inconsistent with the provisions of this part shall not apply to an electing large partnership and its partners.

"SEC. 772. SIMPLIFIED FLOW-THROUGH.

"(a) GENERAL RULE.—In determining the income tax of a partner of an electing large partnership, such partner shall take into account separately such partner's distributive share of the partnership's—

"(1) taxable income or loss from passive loss limitation activities,

"(2) taxable income or loss from other activities,

"(3) net capital gain (or net capital loss)—

"(A) to the extent allocable to passive loss limitation activities, and

"(B) to the extent allocable to other activities,

"(4) tax-exempt interest,

"(5) applicable net AMT adjustment separately computed for—

"(A) passive loss limitation activities, and

"(B) other activities,

"(6) general credits,

"(7) low-income housing credit determined under section 42,

"(8) rehabilitation credit determined under section 47,

"(9) foreign income taxes,

"(10) the credit allowable under section 29, and

"(11) other items to the extent that the Secretary determines that the separate treatment of such items is appropriate.

"(b) SEPARATE COMPUTATIONS.—In determining the amounts required under subsection (a) to be separately taken into account by any partner, this section and section 773 shall be applied separately with respect to such partner by taking into account such partner's distributive share of the items of income, gain, loss, deduction, or credit of the partnership.

"(c) TREATMENT AT PARTNER LEVEL.—

"(1) IN GENERAL.—Except as provided in this subsection, rules similar to the rules of section 702(b) shall apply to any partner's distributive share of the amounts referred to in subsection (a).

"(2) INCOME OR LOSS FROM PASSIVE LOSS LIMITATION ACTIVITIES.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(1) shall be treated as an item of income or loss (as the case may be) from the conduct of a trade or business which is a single passive activity (as defined in section 469). A similar rule shall apply to a partner's distributive share of amounts referred to in paragraphs (3)(A) and (5)(A) of subsection (a).

"(3) INCOME OR LOSS FROM OTHER ACTIVITIES.—

"(A) IN GENERAL.—For purposes of this chapter, any partner's distributive share of any income or loss described in subsection (a)(2) shall be treated as an item of income or expense (as the case may be) with respect to property held for investment.

"(B) DEDUCTIONS FOR LOSS NOT SUBJECT TO SECTION 67.—The deduction under section 212 for any loss described in subparagraph (A) shall not be treated as a miscellaneous itemized deduction for purposes of section 67.

"(4) TREATMENT OF NET CAPITAL GAIN OR LOSS.—For purposes of this chapter, any partner's distributive share of any gain or loss described in subsection (a)(3) shall be treated as a long-term capital gain or loss, as the case may be.

"(5) MINIMUM TAX TREATMENT.—In determining the alternative minimum taxable income of any partner, such partner's distributive share of any applicable net AMT adjustment shall be taken into account in lieu of making the separate adjustments provided in sections 56, 57, and 58 with respect to the items of the partnership. Except as provided in regulations, the applicable net AMT adjustment shall be treated, for purposes of section 53, as an adjustment or item of tax preference not specified in section 53(d)(1)(B)(ii).

"(6) GENERAL CREDITS.—A partner's distributive share of the amount referred to in paragraph (6) of subsection (a) shall be taken into account as a current year business credit.

"(d) OPERATING RULES.—For purposes of this section—

"(1) PASSIVE LOSS LIMITATION ACTIVITY.—The term 'passive loss limitation activity' means—

"(A) any activity which involves the conduct of a trade or business, and

"(B) any rental activity.

For purposes of the preceding sentence, the term 'trade or business' includes any activity treated as a trade or business under paragraph (5) or (6) of section 469(c).

"(2) TAX-EXEMPT INTEREST.—The term 'tax-exempt interest' means interest excludable from gross income under section 103.

"(3) APPLICABLE NET AMT ADJUSTMENT.—

"(A) IN GENERAL.—The applicable net AMT adjustment is—

"(i) with respect to taxpayers other than corporations, the net adjustment determined by using the adjustments applicable to individuals, and

"(ii) with respect to corporations, the net adjustment determined by using the adjustments applicable to corporations.

"(B) NET ADJUSTMENT.—The term 'net adjustment' means the net adjustment in the items attributable to passive loss activities or other activities (as the case may be) which would result if such items were determined with the adjustments of sections 56, 57, and 58.

"(4) TREATMENT OF CERTAIN SEPARATELY STATED ITEMS.—

"(A) EXCLUSION FOR CERTAIN PURPOSES.—In determining the amounts referred to in paragraphs (1) and (2) of subsection (a), any net capital gain or net capital loss (as the case may be), and any item referred to in subsection (a)(11), shall be excluded.

"(B) ALLOCATION RULES.—The net capital gain shall be treated—

"(i) as allocable to passive loss limitation activities to the extent the net capital gain does not exceed the net capital gain determined by only taking into account gains and losses from sales and exchanges of property used in connection with such activities, and

"(ii) as allocable to other activities to the extent such gain exceeds the amount allocated under clause (i).

A similar rule shall apply for purposes of allocating any net capital loss.

"(C) NET CAPITAL LOSS.—The term 'net capital loss' means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchange of capital assets.

"(5) GENERAL CREDITS.—The term 'general credits' means any credit other than the low-income housing credit, the rehabilitation credit, the foreign tax credit, and the credit allowable under section 29.

"(6) FOREIGN INCOME TAXES.—The term 'foreign income taxes' means taxes described in section 901 which are paid or accrued to foreign countries and to possessions of the United States.

"(e) SPECIAL RULE FOR UNRELATED BUSINESS TAX.—In the case of a partner which is an organization subject to tax under section 511, such partner's distributive share of any items shall be taken into account separately to the extent necessary to comply with the provisions of section 512(c)(1).

“(f) SPECIAL RULES FOR APPLYING PASSIVE LOSS LIMITATIONS.—If any person holds an interest in an electing large partnership other than as a limited partner—

“(1) paragraph (2) of subsection (c) shall not apply to such partner, and

“(2) such partner’s distributive share of the partnership items allocable to passive loss limitation activities shall be taken into account separately to the extent necessary to comply with the provisions of section 469.

The preceding sentence shall not apply to any items allocable to an interest held as a limited partner.

“SEC. 773. COMPUTATIONS AT PARTNERSHIP LEVEL.

“(a) GENERAL RULE.—

“(1) TAXABLE INCOME.—The taxable income of an electing large partnership shall be computed in the same manner as in the case of an individual except that—

“(A) the items described in section 772(a) shall be separately stated, and

“(B) the modifications of subsection (b) shall apply.

“(2) ELECTIONS.—All elections affecting the computation of the taxable income of an electing large partnership or the computation of any credit of an electing large partnership shall be made by the partnership; except that the election under section 901, and any election under section 108, shall be made by each partner separately.

“(3) LIMITATIONS, ETC.—

“(A) IN GENERAL.—Except as provided in subparagraph (B), all limitations and other provisions affecting the computation of the taxable income of an electing large partnership or the computation of any credit of an electing large partnership shall be applied at the partnership level (and not at the partner level).

“(B) CERTAIN LIMITATIONS APPLIED AT PARTNER LEVEL.—The following provisions shall be applied at the partner level (and not at the partnership level):

“(i) Section 68 (relating to overall limitation on itemized deductions).

“(ii) Sections 49 and 465 (relating to at risk limitations).

“(iii) Section 469 (relating to limitation on passive activity losses and credits).

“(iv) Any other provision specified in regulations.

“(4) COORDINATION WITH OTHER PROVISIONS.—Paragraphs (2) and (3) shall apply notwithstanding any other provision of this chapter other than this part.

“(b) MODIFICATIONS TO DETERMINATION OF TAXABLE INCOME.—In determining the taxable income of an electing large partnership—

“(1) CERTAIN DEDUCTIONS NOT ALLOWED.—The following deductions shall not be allowed:

“(A) The deduction for personal exemptions provided in section 151.

“(B) The net operating loss deduction provided in section 172.

"(C) The additional itemized deductions for individuals provided in part VII of subchapter B (other than section 212 thereof).

"(2) CHARITABLE DEDUCTIONS.—In determining the amount allowable under section 170, the limitation of section 170(b)(2) shall apply.

"(3) COORDINATION WITH SECTION 67.—In lieu of applying section 67, 70 percent of the amount of the miscellaneous itemized deductions shall be disallowed.

"(c) SPECIAL RULES FOR INCOME FROM DISCHARGE OF INDEBTEDNESS.—If an electing large partnership has income from the discharge of any indebtedness—

"(1) such income shall be excluded in determining the amounts referred to in section 772(a), and

"(2) in determining the income tax of any partner of such partnership—

"(A) such income shall be treated as an item required to be separately taken into account under section 772(a), and

"(B) the provisions of section 108 shall be applied without regard to this part.

"SEC. 774. OTHER MODIFICATIONS.

"(a) TREATMENT OF CERTAIN OPTIONAL ADJUSTMENTS, ETC.—In the case of an electing large partnership—

"(1) computations under section 773 shall be made without regard to any adjustment under section 743(b) or 108(b), but

"(2) a partner's distributive share of any amount referred to in section 772(a) shall be appropriately adjusted to take into account any adjustment under section 743(b) or 108(b) with respect to such partner.

"(b) CREDIT RECAPTURE DETERMINED AT PARTNERSHIP LEVEL.—

"(1) IN GENERAL.—In the case of an electing large partnership—

"(A) any credit recapture shall be taken into account by the partnership, and

"(B) the amount of such recapture shall be determined as if the credit with respect to which the recapture is made had been fully utilized to reduce tax.

"(2) METHOD OF TAKING RECAPTURE INTO ACCOUNT.—An electing large partnership shall take into account a credit recapture by reducing the amount of the appropriate current year credit to the extent thereof, and if such recapture exceeds the amount of such current year credit, the partnership shall be liable to pay such excess.

"(3) DISPOSITIONS NOT TO TRIGGER RECAPTURE.—No credit recapture shall be required by reason of any transfer of an interest in an electing large partnership.

"(4) CREDIT RECAPTURE.—For purposes of this subsection, the term 'credit recapture' means any increase in tax under section 42(j) or 50(a).

"(c) PARTNERSHIP NOT TERMINATED BY REASON OF CHANGE IN OWNERSHIP.—Subparagraph (B) of section 708(b)(1) shall not apply to an electing large partnership.

"(d) PARTNERSHIP ENTITLED TO CERTAIN CREDITS.—The following shall be allowed to an electing large partnership and shall not be taken into account by the partners of such partnership:

"(1) The credit provided by section 34.

"(2) Any credit or refund under section 852(b)(3)(D).

"(e) TREATMENT OF REMIC RESIDUALS.—For purposes of applying section 860E(e)(6) to any electing large partnership—

"(1) all interests in such partnership shall be treated as held by disqualified organizations,

"(2) in lieu of applying subparagraph (C) of section 860E(e)(6), the amount subject to tax under section 860E(e)(6) shall be excluded from the gross income of such partnership, and

"(3) subparagraph (D) of section 860E(e)(6) shall not apply.

"(f) SPECIAL RULES FOR APPLYING CERTAIN INSTALLMENT SALE RULES.—In the case of an electing large partnership—

"(1) the provisions of sections 453(l)(3) and 453A shall be applied at the partnership level, and

"(2) in determining the amount of interest payable under such sections, such partnership shall be treated as subject to tax under this chapter at the highest rate of tax in effect under section 1 or 11.

"SEC. 775. ELECTING LARGE PARTNERSHIP DEFINED.

"(a) GENERAL RULE.—For purposes of this part—

"(1) IN GENERAL.—The term 'electing large partnership' means, with respect to any partnership taxable year, any partnership if—

"(A) the number of persons who were partners in such partnership in the preceding partnership taxable year equaled or exceeded 100, and

"(B) such partnership elects the application of this part.

To the extent provided in regulations, a partnership shall cease to be treated as an electing large partnership for any partnership taxable year if in such taxable year fewer than 100 persons were partners in such partnership.

"(2) ELECTION.—The election under this subsection shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

"(b) SPECIAL RULES FOR CERTAIN SERVICE PARTNERSHIPS.—

"(1) CERTAIN PARTNERS NOT COUNTED.—For purposes of this section, the term 'partner' does not include any individual performing substantial services in connection with the activities of the partnership and holding an interest in such partnership, or an individual who formerly performed substantial services in connection with such activities and who held an interest in such partnership at the time the individual performed such services.

"(2) EXCLUSION.—For purposes of this part, an election under subsection (a) shall not be effective with respect to any partnership if substantially all the partners of such partnership—

"(A) are individuals performing substantial services in connection with the activities of such partnership or are

personal service corporations (as defined in section 269A(b)) the owner-employees (as defined in section 269A(b)) of which perform such substantial services,

“(B) are retired partners who had performed such substantial services, or

“(C) are spouses of partners who are performing (or had previously performed) such substantial services.

“(3) SPECIAL RULE FOR LOWER TIER PARTNERSHIPS.—For purposes of this subsection, the activities of a partnership shall include the activities of any other partnership in which the partnership owns directly an interest in the capital and profits of at least 80 percent.

“(c) EXCLUSION OF COMMODITY POOLS.—For purposes of this part, an election under subsection (a) shall not be effective with respect to any partnership the principal activity of which is the buying and selling of commodities (not described in section 1221(1)), or options, futures, or forwards with respect to such commodities.

“(d) SECRETARY MAY RELY ON TREATMENT ON RETURN.—If, on the partnership return of any partnership, such partnership is treated as an electing large partnership, such treatment shall be binding on such partnership and all partners of such partnership but not on the Secretary.

“SEC. 776. SPECIAL RULES FOR PARTNERSHIPS HOLDING OIL AND GAS PROPERTIES.

“(a) COMPUTATION OF PERCENTAGE DEPLETION.—In the case of an electing large partnership, except as provided in subsection (b)—

“(1) the allowance for depletion under section 611 with respect to any partnership oil or gas property shall be computed at the partnership level without regard to any provision of section 613A requiring such allowance to be computed separately by each partner,

“(2) such allowance shall be determined without regard to the provisions of section 613A(c) limiting the amount of production for which percentage depletion is allowable and without regard to paragraph (1) of section 613A(d), and

“(3) paragraph (3) of section 705(a) shall not apply.

“(b) TREATMENT OF CERTAIN PARTNERS.—

“(1) IN GENERAL.—In the case of a disqualified person, the treatment under this chapter of such person’s distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property shall be determined without regard to this part. Such person’s distributive share of any such items shall be excluded for purposes of making determinations under sections 772 and 773.

“(2) DISQUALIFIED PERSON.—For purposes of paragraph (1), the term ‘disqualified person’ means, with respect to any partnership taxable year—

“(A) any person referred to in paragraph (2) or (4) of section 613A(d) for such person’s taxable year in which such partnership taxable year ends, and

“(B) any other person if such person’s average daily production of domestic crude oil and natural gas for such person’s taxable year in which such partnership taxable year ends exceeds 500 barrels.

"(3) AVERAGE DAILY PRODUCTION.—For purposes of paragraph (2), a person's average daily production of domestic crude oil and natural gas for any taxable year shall be computed as provided in section 613A(c)(2)—

"(A) by taking into account all production of domestic crude oil and natural gas (including such person's proportionate share of any production of a partnership),

"(B) by treating 6,000 cubic feet of natural gas as a barrel of crude oil, and

"(C) by treating as 1 person all persons treated as 1 taxpayer under section 613A(c)(8) or among whom allocations are required under such section.

"SEC. 777. REGULATIONS.

"The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this part.".

(b) CLERICAL AMENDMENT.—The table of parts for subchapter K of chapter 1 is amended by adding at the end the following new item:

"Part IV. Special rules for electing large partnerships.".

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

SEC. 1222. SIMPLIFIED AUDIT PROCEDURES FOR ELECTING LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Chapter 63 is amended by adding at the end thereof the following new subchapter:

"Subchapter D—Treatment of electing large partnerships

"PART I—TREATMENT OF PARTNERSHIP ITEMS AND ADJUSTMENTS

"SEC. 6240. APPLICATION OF SUBCHAPTER.

"(a) GENERAL RULE.—This subchapter shall only apply to electing large partnerships and partners in such partnerships.

"(b) COORDINATION WITH OTHER PARTNERSHIP AUDIT PROCEDURES.—

"(1) IN GENERAL.—Subchapter C of this chapter shall not apply to any electing large partnership other than in its capacity as a partner in another partnership which is not an electing large partnership.

"(2) TREATMENT WHERE PARTNER IN OTHER PARTNERSHIP.—If an electing large partnership is a partner in another partnership which is not an electing large partnership—

“(A) subchapter C of this chapter shall apply to items of such electing large partnership which are partnership items with respect to such other partnership, but

“(B) any adjustment under such subchapter C shall be taken into account in the manner provided by section 6242.

“SEC. 6241. PARTNER’S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN.

“(a) GENERAL RULE.—A partner of any electing large partnership shall, on the partner’s return, treat each partnership item attributable to such partnership in a manner which is consistent with the treatment of such partnership item on the partnership return.

“(b) UNDERPAYMENT DUE TO INCONSISTENT TREATMENT ASSESSED AS MATH ERROR.—Any underpayment of tax by a partner by reason of failing to comply with the requirements of subsection (a) shall be assessed and collected in the same manner as if such underpayment were on account of a mathematical or clerical error appearing on the partner’s return. Paragraph (2) of section 6213(b) shall not apply to any assessment of an underpayment referred to in the preceding sentence.

“(c) ADJUSTMENTS NOT TO AFFECT PRIOR YEAR OF PARTNERS.—

“(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a) and (b) shall apply without regard to any adjustment to the partnership item under part II.

“(2) CERTAIN CHANGES IN DISTRIBUTIVE SHARE TAKEN INTO ACCOUNT BY PARTNER.—

“(A) IN GENERAL.—To the extent that any adjustment under part II involves a change under section 704 in a partner’s distributive share of the amount of any partnership item shown on the partnership return, such adjustment shall be taken into account in applying this title to such partner for the partner’s taxable year for which such item was required to be taken into account.

“(B) COORDINATION WITH DEFICIENCY PROCEDURES.—

“(i) IN GENERAL.—Subchapter B shall not apply to the assessment or collection of any underpayment of tax attributable to an adjustment referred to in subparagraph (A).

“(ii) ADJUSTMENT NOT PRECLUDED.—Notwithstanding any other law or rule of law, nothing in subchapter B (or in any proceeding under subchapter B) shall preclude the assessment or collection of any underpayment of tax (or the allowance of any credit or refund of any overpayment of tax) attributable to an adjustment referred to in subparagraph (A) and such assessment or collection or allowance (or any notice thereof) shall not preclude any notice, proceeding, or determination under subchapter B.

“(C) PERIOD OF LIMITATIONS.—The period for—

“(i) assessing any underpayment of tax, or

“(ii) filing a claim for credit or refund of any overpayment of tax,

attributable to an adjustment referred to in subparagraph (A) shall not expire before the close of the period prescribed *by section 6248 for making adjustments with respect to the partnership taxable year involved.*

"(D) TIERED STRUCTURES.—If the partner referred to in subparagraph (A) is another partnership or an S corporation, the rules of this paragraph shall also apply to persons holding interests in such partnership or S corporation (as the case may be); except that, if such partner is an electing large partnership, the adjustment referred to in subparagraph (A) shall be taken into account in the manner provided by section 6242.

"(d) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—

"For addition to tax in case of partner's disregard of requirements of this section, see part II of subchapter A of chapter 68.

"SEC. 6242. PROCEDURES FOR TAKING PARTNERSHIP ADJUSTMENTS INTO ACCOUNT.

"(a) ADJUSTMENTS FLOW THROUGH TO PARTNERS FOR YEAR IN WHICH ADJUSTMENT TAKES EFFECT.—

"(1) IN GENERAL.—If any partnership adjustment with respect to any partnership item takes effect (within the meaning of subsection (d)(2)) during any partnership taxable year and if an election under paragraph (2) does not apply to such adjustment, such adjustment shall be taken into account in determining the amount of such item for the partnership taxable year in which such adjustment takes effect. In applying this title to any person who is (directly or indirectly) a partner in such partnership during such partnership taxable year, such adjustment shall be treated as an item actually arising during such taxable year.

"(2) PARTNERSHIP LIABLE IN CERTAIN CASES.—If—

"(A) a partnership elects under this paragraph to not take an adjustment into account under paragraph (1),

"(B) a partnership does not make such an election but in filing its return for any partnership taxable year fails to take fully into account any partnership adjustment as required under paragraph (1), or

"(C) any partnership adjustment involves a reduction in a credit which exceeds the amount of such credit determined for the partnership taxable year in which the adjustment takes effect,

the partnership shall pay to the Secretary an amount determined by applying the rules of subsection (b)(4) to the adjustments not so taken into account and any excess referred to in subparagraph (C).

"(3) OFFSETTING ADJUSTMENTS TAKEN INTO ACCOUNT.—If a partnership adjustment requires another adjustment in a taxable year after the adjusted year and before the partnership taxable year in which such partnership adjustment takes effect, such other adjustment shall be taken into account under this subsection for the partnership taxable year in which such partnership adjustment takes effect.

"(4) COORDINATION WITH PART II.—Amounts taken into account under this subsection for any partnership taxable year shall continue to be treated as adjustments for the adjusted

year for purposes of determining whether such amounts may be readjusted under part II.

"(b) PARTNERSHIP LIABLE FOR INTEREST AND PENALTIES.—

"(1) IN GENERAL.—If a partnership adjustment takes effect during any partnership taxable year and such adjustment results in an imputed underpayment for the adjusted year, the partnership—

"(A) shall pay to the Secretary interest computed under paragraph (2), and

"(B) shall be liable for any penalty, addition to tax, or additional amount as provided in paragraph (3).

"(2) DETERMINATION OF AMOUNT OF INTEREST.—The interest computed under this paragraph with respect to any partnership adjustment is the interest which would be determined under chapter 67—

"(A) on the imputed underpayment determined under paragraph (4) with respect to such adjustment,

"(B) for the period beginning on the day after the return due date for the adjusted year and ending on the return due date for the partnership taxable year in which such adjustment takes effect (or, if earlier, in the case of any adjustment to which subsection (a)(2) applies, the date on which the payment under subsection (a)(2) is made).

Proper adjustments in the amount determined under the preceding sentence shall be made for adjustments required for partnership taxable years after the adjusted year and before the year in which the partnership adjustment takes effect by reason of such partnership adjustment.

"(3) PENALTIES.—A partnership shall be liable for any penalty, addition to tax, or additional amount for which it would have been liable if such partnership had been an individual subject to tax under chapter 1 for the adjusted year and the imputed underpayment determined under paragraph (4) were an actual underpayment (or understatement) for such year.

"(4) IMPUTED UNDERPAYMENT.—For purposes of this subsection, the imputed underpayment determined under this paragraph with respect to any partnership adjustment is the underpayment (if any) which would result—

"(A) by netting all adjustments to items of income, gain, loss, or deduction and by treating any net increase in income as an underpayment equal to the amount of such net increase multiplied by the highest rate of tax in effect under section 1 or 11 for the adjusted year, and

"(B) by taking adjustments to credits into account as increases or decreases (whichever is appropriate) in the amount of tax.

For purposes of the preceding sentence, any net decrease in a loss shall be treated as an increase in income and a similar rule shall apply to a net increase in a loss.

"(c) ADMINISTRATIVE PROVISIONS.—

"(1) IN GENERAL.—Any payment required by subsection (a)(2) or (b)(1)(A)—

"(A) shall be assessed and collected in the same manner as if it were a tax imposed by subtitle C, and

"(B) shall be paid on or before the return due date for the partnership taxable year in which the partnership adjustment takes effect.

"(2) INTEREST.—For purposes of determining interest, any payment required by subsection (a)(2) or (b)(1)(A) shall be treated as an underpayment of tax.

"(3) PENALTIES.—

"(A) IN GENERAL.—In the case of any failure by any partnership to pay on the date prescribed therefor any amount required by subsection (a)(2) or (b)(1)(A), there is hereby imposed on such partnership a penalty of 10 percent of the underpayment. For purposes of the preceding sentence, the term 'underpayment' means the excess of any payment required under this section over the amount (if any) paid on or before the date prescribed therefor.

"(B) ACCURACY-RELATED AND FRAUD PENALTIES MADE APPLICABLE.—For purposes of part II of subchapter A of chapter 68, any payment required by subsection (a)(2) shall be treated as an underpayment of tax.

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

"(1) PARTNERSHIP ADJUSTMENT.—The term 'partnership adjustment' means any adjustment in the amount of any partnership item of an electing large partnership.

"(2) WHEN ADJUSTMENT TAKES EFFECT.—A partnership adjustment takes effect—

"(A) in the case of an adjustment pursuant to the decision of a court in a proceeding brought under part II, when such decision becomes final,

"(B) in the case of an adjustment pursuant to any administrative adjustment request under section 6251, when such adjustment is allowed by the Secretary, or

"(C) in any other case, when such adjustment is made.

"(3) ADJUSTED YEAR.—The term 'adjusted year' means the partnership taxable year to which the item being adjusted relates.

"(4) RETURN DUE DATE.—The term 'return due date' means, with respect to any taxable year, the date prescribed for filing the partnership return for such taxable year (determined without regard to extensions).

"(5) ADJUSTMENTS INVOLVING CHANGES IN CHARACTER.—Under regulations, appropriate adjustments in the application of this section shall be made for purposes of taking into account partnership adjustments which involve a change in the character of any item of income, gain, loss, or deduction.

"(e) PAYMENTS NONDEDUCTIBLE.—No deduction shall be allowed under subtitle A for any payment required to be made by an electing large partnership under this section.

"PART II—PARTNERSHIP LEVEL ADJUSTMENTS

“Subpart A—Adjustments by Secretary

“SEC. 6245. SECRETARIAL AUTHORITY.

“(a) GENERAL RULE.—The Secretary is authorized and directed to make adjustments at the partnership level in any partnership item to the extent necessary to have such item be treated in the manner required.

“(b) NOTICE OF PARTNERSHIP ADJUSTMENT.—

“(1) IN GENERAL.—If the Secretary determines that a partnership adjustment is required, the Secretary is authorized to send notice of such adjustment to the partnership by certified mail or registered mail. Such notice shall be sufficient if mailed to the partnership at its last known address even if the partnership has terminated its existence.

“(2) FURTHER NOTICES RESTRICTED.—If the Secretary mails a notice of a partnership adjustment to any partnership for any partnership taxable year and the partnership files a petition under section 6247 with respect to such notice, in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact, the Secretary shall not mail another such notice to such partnership with respect to such taxable year.

“(3) AUTHORITY TO RESCIND NOTICE WITH PARTNERSHIP CONSENT.—The Secretary may, with the consent of the partnership, rescind any notice of a partnership adjustment mailed to such partnership. Any notice so rescinded shall not be treated as a notice of a partnership adjustment, for purposes of this section, section 6246, and section 6247, and the taxpayer shall have no right to bring a proceeding under section 6247 with respect to such notice. Nothing in this subsection shall affect any suspension of the running of any period of limitations during any period any period during which the rescinded notice was outstanding.

“SEC. 6246. RESTRICTIONS ON PARTNERSHIP ADJUSTMENTS.

“(a) GENERAL RULE.—Except as otherwise provided in this chapter, no adjustment to any partnership item may be made (and no levy or proceeding in any court for the collection of any amount resulting from such adjustment may be made, begun or prosecuted) before—

“(1) the close of the 90th day after the day on which a notice of a partnership adjustment was mailed to the partnership, and

“(2) if a petition is filed under section 6247 with respect to such notice, the decision of the court has become final.

“(b) PREMATURE ACTION MAY BE ENJOINED.—Notwithstanding section 7421(a), any action which violates subsection (a) may be enjoined in the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action under this subsection unless a timely petition has been filed under section 6247 and then only in respect of the adjustments that are the subject of such petition.

"(c) EXCEPTIONS TO RESTRICTIONS ON ADJUSTMENTS.—

"(1) ADJUSTMENTS ARISING OUT OF MATH OR CLERICAL ERRORS.—

"(A) IN GENERAL.—If the partnership is notified that, on account of a mathematical or clerical error appearing on the partnership return, an adjustment to a partnership item is required, rules similar to the rules of paragraphs (1) and (2) of section 6213(b) shall apply to such adjustment.

"(B) SPECIAL RULE.—If an electing large partnership is a partner in another electing large partnership, any adjustment on account of such partnership's failure to comply with the requirements of section 6241(a) with respect to its interest in such other partnership shall be treated as an adjustment referred to in subparagraph (A), except that paragraph (2) of section 6213(b) shall not apply to such adjustment.

"(2) PARTNERSHIP MAY WAIVE RESTRICTIONS.—The partnership shall at any time (whether or not a notice of partnership adjustment has been issued) have the right, by a signed notice in writing filed with the Secretary, to waive the restrictions provided in subsection (a) on the making of any partnership adjustment.

"(d) LIMIT WHERE NO PROCEEDING BEGUN.—If no proceeding under section 6247 is begun with respect to any notice of a partnership adjustment during the 90-day period described in subsection (a), the amount for which the partnership is liable under section 6242 (and any increase in any partner's liability for tax under chapter 1 by reason of any adjustment under section 6242(a)) shall not exceed the amount determined in accordance with such notice.

"SEC. 6247. JUDICIAL REVIEW OF PARTNERSHIP ADJUSTMENT.

"(a) GENERAL RULE.—Within 90 days after the date on which a notice of a partnership adjustment is mailed to the partnership with respect to any partnership taxable year, the partnership may file a petition for a readjustment of the partnership items for such taxable year with—

"(1) the Tax Court,

"(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

"(3) the Claims Court.

"(b) JURISDICTIONAL REQUIREMENT FOR BRINGING ACTION IN DISTRICT COURT OR CLAIMS COURT.—

"(1) IN GENERAL.—A readjustment petition under this section may be filed in a district court of the United States or the Claims Court only if the partnership filing the petition deposits with the Secretary, on or before the date the petition is filed, the amount for which the partnership would be liable under section 6242(b) (as of the date of the filing of the petition) if the partnership items were adjusted as provided by the notice of partnership adjustment. The court may by order provide that the jurisdictional requirements of this paragraph are satisfied where there has been a good faith attempt to satisfy such requirement

and any shortfall of the amount required to be deposited is timely corrected.

"(2) INTEREST PAYABLE.—Any amount deposited under paragraph (1), while deposited, shall not be treated as a payment of tax for purposes of this title (other than chapter 67).

"(c) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates and the proper allocation of such items among the partners (and the applicability of any penalty, addition to tax, or additional amount for which the partnership may be liable under section 6242(b)).

"(d) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

"(e) EFFECT OF DECISION DISMISSING ACTION.—If an action brought under this section is dismissed other than by reason of a rescission under section 6245(b)(3), the decision of the court dismissing the action shall be considered as its decision that the notice of partnership adjustment is correct, and an appropriate order shall be entered in the records of the court.

"SEC. 6248. PERIOD OF LIMITATIONS FOR MAKING ADJUSTMENTS.

"(a) GENERAL RULE.—Except as otherwise provided in this section, no adjustment under this subpart to any partnership item for any partnership taxable year may be made after the date which is 3 years after the later of—

"(1) the date on which the partnership return for such taxable year was filed, or

"(2) the last day for filing such return for such year (determined without regard to extensions).

"(b) EXTENSION BY AGREEMENT.—The period described in subsection (a) (including an extension period under this subsection) may be extended by an agreement entered into by the Secretary and the partnership before the expiration of such period.

"(c) SPECIAL RULE IN CASE OF FRAUD, ETC.—

"(1) FALSE RETURN.—In the case of a false or fraudulent partnership return with intent to evade tax, the adjustment may be made at any time.

"(2) SUBSTANTIAL OMISSION OF INCOME.—If any partnership omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in its return, subsection (a) shall be applied by substituting '6 years' for '3 years'.

"(3) NO RETURN.—In the case of a failure by a partnership to file a return for any taxable year, the adjustment may be made at any time.

"(4) RETURN FILED BY SECRETARY.—For purposes of this section, a return executed by the Secretary under subsection (b) of section 6020 on behalf of the partnership shall not be treated as a return of the partnership.

"(d) SUSPENSION WHEN SECRETARY MAILS NOTICE OF ADJUSTMENT.—If notice of a partnership adjustment with respect to any taxable year is mailed to the partnership, the running of the period specified in subsection (a) (as modified by the other provisions of this section) shall be suspended—

"(1) for the period during which an action may be brought under section 6247 (and, if a petition is filed under section 6247 with respect to such notice, until the decision of the court becomes final), and

"(2) for 1 year thereafter.

"Subpart B—Claims for Adjustments by Partnership

"SEC. 6251. ADMINISTRATIVE ADJUSTMENT REQUESTS.

"(a) GENERAL RULE.—A partnership may file a request for an administrative adjustment of partnership items for any partnership taxable year at any time which is—

"(1) within 3 years after the later of—

"(A) the date on which the partnership return for such year is filed, or

"(B) the last day for filing the partnership return for such year (determined without regard to extensions), and

"(2) before the mailing to the partnership of a notice of a partnership adjustment with respect to such taxable year.

"(b) SECRETARIAL ACTION.—If a partnership files an administrative adjustment request under subsection (a), the Secretary may allow any part of the requested adjustments.

"(c) SPECIAL RULE IN CASE OF EXTENSION UNDER SECTION 6248.—If the period described in section 6248(a) is extended pursuant to an agreement under section 6248(b), the period prescribed by subsection (a)(1) shall not expire before the date 6 months after the expiration of the extension under section 6248(b).

"SEC. 6252. JUDICIAL REVIEW WHERE ADMINISTRATIVE ADJUSTMENT REQUEST IS NOT ALLOWED IN FULL.

"(a) IN GENERAL.—If any part of an administrative adjustment request filed under section 6251 is not allowed by the Secretary, the partnership may file a petition for an adjustment with respect to the partnership items to which such part of the request relates with—

"(1) the Tax Court,

"(2) the district court of the United States for the district in which the principal place of business of the partnership is located, or

"(3) the Claims Court.

"(b) PERIOD FOR FILING PETITION.—A petition may be filed under subsection (a) with respect to partnership items for a partnership taxable year only—

"(1) after the expiration of 6 months from the date of filing of the request under section 6251, and

"(2) before the date which is 2 years after the date of such request.

The 2-year period set forth in paragraph (2) shall be extended for such period as may be agreed upon in writing by the partnership and the Secretary.

"(c) COORDINATION WITH SUBPART A.—

"(1) NOTICE OF PARTNERSHIP ADJUSTMENT BEFORE FILING OF PETITION.—No petition may be filed under this section after the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates.

"(2) NOTICE OF PARTNERSHIP ADJUSTMENT AFTER FILING BUT BEFORE HEARING OF PETITION.—If the Secretary mails to the partnership a notice of a partnership adjustment for the partnership taxable year to which the request under section 6251 relates after the filing of a petition under this subsection but before the hearing of such petition, such petition shall be treated as an action brought under section 6247 with respect to such notice, except that subsection (b) of section 6247 shall not apply.

"(3) NOTICE MUST BE BEFORE EXPIRATION OF STATUTE OF LIMITATIONS.—A notice of a partnership adjustment for the partnership taxable year shall be taken into account under paragraphs (1) and (2) only if such notice is mailed before the expiration of the period prescribed by section 6248 for making adjustments to partnership items for such taxable year.

"(d) SCOPE OF JUDICIAL REVIEW.—Except in the case described in paragraph (2) of subsection (c), a court with which a petition is filed in accordance with this section shall have jurisdiction to determine only those partnership items to which the part of the request under section 6251 not allowed by the Secretary relates and those items with respect to which the Secretary asserts adjustments as offsets to the adjustments requested by the partnership.

"(e) DETERMINATION OF COURT REVIEWABLE.—Any determination by a court under this section shall have the force and effect of a decision of the Tax Court or a final judgment or decree of the district court or the Claims Court, as the case may be, and shall be reviewable as such. The date of any such determination shall be treated as being the date of the court's order entering the decision.

"PART III—DEFINITIONS AND SPECIAL RULES

"SEC. 6255. DEFINITIONS AND SPECIAL RULES.

"(a) DEFINITIONS.—For purposes of this subchapter—

"(1) ELECTING LARGE PARTNERSHIP.—The term 'electing large partnership' has the meaning given to such term by section 775.

"(2) PARTNERSHIP ITEM.—The term 'partnership item' has the meaning given to such term by section 6231(a)(3).

"(b) PARTNERS BOUND BY ACTIONS OF PARTNERSHIP, ETC.—

"(1) DESIGNATION OF PARTNER.—Each electing large partnership shall designate (in the manner prescribed by the Secretary) a partner (or other person) who shall have the sole authority to act on behalf of such partnership under this subchapter. In any case in which such a designation is not in ef-

fect, the Secretary may select any partner as the partner with such authority.

"(2) BINDING EFFECT.—An electing large partnership and all partners of such partnership shall be bound—

"(A) by actions taken under this subchapter by the partnership, and

"(B) by any decision in a proceeding brought under this subchapter.

"(c) PARTNERSHIPS HAVING PRINCIPAL PLACE OF BUSINESS OUTSIDE THE UNITED STATES.—For purposes of sections 6247 and 6252, a principal place of business located outside the United States shall be treated as located in the District of Columbia.

"(d) TREATMENT WHERE PARTNERSHIP CEASES TO EXIST.—If a partnership ceases to exist before a partnership adjustment under this subchapter takes effect, such adjustment shall be taken into account by the former partners of such partnership under regulations prescribed by the Secretary.

"(e) DATE DECISION BECOMES FINAL.—For purposes of this subchapter, the principles of section 7481(a) shall be applied in determining the date on which a decision of a district court or the Claims Court becomes final.

"(f) PARTNERSHIPS IN CASES UNDER TITLE 11 OF THE UNITED STATES CODE.—

"(1) SUSPENSION OF PERIOD OF LIMITATIONS ON MAKING ADJUSTMENT, ASSESSMENT, OR COLLECTION.—The running of any period of limitations provided in this subchapter on making a partnership adjustment (or provided by section 6501 or 6502 on the assessment or collection of any amount required to be paid under section 6242) shall, in a case under title 11 of the United States Code, be suspended during the period during which the Secretary is prohibited by reason of such case from making the adjustment (or assessment or collection) and—

"(A) for adjustment or assessment, 60 days thereafter, and

"(B) for collection, 6 months thereafter.

A rule similar to the rule of section 6213(f)(2) shall apply for purposes of section 6246.

"(2) SUSPENSION OF PERIOD OF LIMITATION FOR FILING FOR JUDICIAL REVIEW.—The running of the period specified in section 6247(a) or 6252(b) shall, in a case under title 11 of the United States Code, be suspended during the period during which the partnership is prohibited by reason of such case from filing a petition under section 6247 or 6252 and for 60 days thereafter.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this subchapter, including regulations—

"(1) to prevent abuse through manipulation of the provisions of this subchapter, and

"(2) providing that this subchapter shall not apply to any case described in section 6231(c)(1) (or the regulations prescribed thereunder) where the application of this subchapter to such a case would interfere with the effective and efficient enforcement of this title.

In any case to which this subchapter does not apply by reason of paragraph (2), rules similar to the rules of sections 6229(f) and 6255(f) shall apply.".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (a) of section 7421 is amended by inserting "6246(b)," after "6213(a),".

(2) Subsection (c) of section 7459 is amended by striking "or section 6228(a)" and inserting ", 6228(a), 6247, or 6252".

(3) Subparagraph (E) of section 7482(b)(1) is amended by striking "or 6228(a)" and inserting ", 6228(a), 6247, or 6252".

(4)(A) The text of section 7485(b) is amended by striking "or 6228(a)" and inserting ", 6228(a), 6247, or 6252".

(B) The subsection heading for section 7485(b) is amended to read as follows:

"(b) BOND IN CASE OF APPEAL OF CERTAIN PARTNERSHIP-RELATED DECISIONS.—".

(c) CLERICAL AMENDMENT.—The table of subchapters for chapter 63 is amended by adding at the end thereof the following new item:

"Subchapter D. Treatment of electing large partnerships.".

SEC. 1223. DUE DATE FOR FURNISHING INFORMATION TO PARTNERS OF ELECTING LARGE PARTNERSHIPS.

(a) GENERAL RULE.—Subsection (b) of section 6031 (relating to copies to partners) is amended by adding at the end the following new sentence: "In the case of an electing large partnership (as defined in section 775), such information shall be furnished on or before the first March 15 following the close of such taxable year.".

(b) TREATMENT AS INFORMATION RETURN.—Section 6724 is amended by adding at the end the following new subsection:

"(e) SPECIAL RULE FOR CERTAIN PARTNERSHIP RETURNS.—If any partnership return under section 6031(a) is required under section 6011(e) to be filed on magnetic media or in other machine-readable form, for purposes of this part, each schedule required to be included with such return with respect to each partner shall be treated as a separate information return.".

SEC. 1224. RETURNS REQUIRED ON MAGNETIC MEDIA.

Paragraph (2) of section 6011(e) (relating to returns on magnetic media) is amended by adding at the end thereof the following new sentence:

"Notwithstanding the preceding sentence, the Secretary shall require partnerships having more than 100 partners to file returns on magnetic media.".

SEC. 1225. TREATMENT OF PARTNERSHIP ITEMS OF INDIVIDUAL RETIREMENT ACCOUNTS.

Subsection (b) of section 6012 is amended by adding at the end thereof the following new paragraph:

"(6) IRA SHARE OF PARTNERSHIP INCOME.—In the case of a trust which is exempt from taxation under section 408(e), for purposes of this section, the trust's distributive share of items of gross income and gain of any partnership to which subchapter C or D of chapter 63 applies shall be treated as equal to the trust's distributive share of the taxable income of such partnership.".

SEC. 1226. EFFECTIVE DATE.

The amendments made by this part shall apply to partnership taxable years ending on or after December 31, 1997.

PART II—PROVISIONS RELATED TO TEFRA PARTNERSHIP PROCEEDINGS

SEC. 1231. TREATMENT OF PARTNERSHIP ITEMS IN DEFICIENCY PROCEEDINGS.

(a) IN GENERAL.—Subchapter C of chapter 63 is amended by adding at the end the following new section:

"SEC. 6234. DECLARATORY JUDGMENT RELATING TO TREATMENT OF ITEMS OTHER THAN PARTNERSHIP ITEMS WITH RESPECT TO AN OVERSHELTERED RETURN.

"(a) GENERAL RULE.—If—

"(1) a taxpayer files an oversheltered return for a taxable year,

"(2) the Secretary makes a determination with respect to the treatment of items (other than partnership items) of such taxpayer for such taxable year, and

"(3) the adjustments resulting from such determination do not give rise to a deficiency (as defined in section 6211) but would give rise to a deficiency if there were no net loss from partnership items,

the Secretary is authorized to send a notice of adjustment reflecting such determination to the taxpayer by certified or registered mail.

"(b) OVERSHELTERED RETURN.—For purposes of this section, the term 'oversheltered return' means an income tax return which—

"(1) shows no taxable income for the taxable year, and

"(2) shows a net loss from partnership items.

"(c) JUDICIAL REVIEW IN THE TAX COURT.—Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the day on which the notice of adjustment authorized in subsection (a) is mailed to the taxpayer, the taxpayer may file a petition with the Tax Court for redetermination of the adjustments. Upon the filing of such a petition, the Tax Court shall have jurisdiction to make a declaration with respect to all items (other than partnership items and affected items which require partner level determinations as described in section 6230(a)(2)(A)(i)) for the taxable year to which the notice of adjustment relates, in accordance with the principles of section 6214(a). Any such declaration shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

"(d) FAILURE TO FILE PETITION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), if the taxpayer does not file a petition with the Tax Court within the time prescribed in subsection (c), the determination of the Secretary set forth in the notice of adjustment that was mailed to the taxpayer shall be deemed to be correct.

"(2) EXCEPTION.—Paragraph (1) shall not apply after the date that the taxpayer—

"(A) files a petition with the Tax Court within the time prescribed in subsection (c) with respect to a subsequent notice of adjustment relating to the same taxable year, or

"(B) files a claim for refund of an overpayment of tax under section 6511 for the taxable year involved.

If a claim for refund is filed by the taxpayer, then solely for purposes of determining (for the taxable year involved) the amount of any computational adjustment in connection with a partnership proceeding under this subchapter (other than under this section) or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), the items that are the subject of the notice of adjustment shall be presumed to have been correctly reported on the taxpayer's return during the pendency of the refund claim (and, if within the time prescribed by section 6532 the taxpayer commences a civil action for refund under section 7422, until the decision in the refund action becomes final).

"(e) LIMITATIONS PERIOD.—

"(1) IN GENERAL.—Any notice to a taxpayer under subsection (a) shall be mailed before the expiration of the period prescribed by section 6501 (relating to the period of limitations on assessment).

"(2) SUSPENSION WHEN SECRETARY MAILS NOTICE OF ADJUSTMENT.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year, the period of limitations on the making of assessments shall be suspended for the period during which the Secretary is prohibited from making the assessment (and, in any event, if a proceeding in respect of the notice of adjustment is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter.

"(3) RESTRICTIONS ON ASSESSMENT.—Except as otherwise provided in section 6851, 6852, or 6861, no assessment of a deficiency with respect to any tax imposed by subtitle A attributable to any item (other than a partnership item or any item affected by a partnership item) shall be made—

"(A) until the expiration of the applicable 90-day or 150-day period set forth in subsection (c) for filing a petition with the Tax Court, or

"(B) if a petition has been filed with the Tax Court, until the decision of the Tax Court has become final.

"(f) FURTHER NOTICES OF ADJUSTMENT RESTRICTED.—If the Secretary mails a notice of adjustment to the taxpayer for a taxable year and the taxpayer files a petition with the Tax Court within the time prescribed in subsection (c), the Secretary may not mail another such notice to the taxpayer with respect to the same taxable year in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact.

"(g) COORDINATION WITH OTHER PROCEEDINGS UNDER THIS SUBCHAPTER.—

"(1) IN GENERAL.—The treatment of any item that has been determined pursuant to subsection (c) or (d) shall be taken into account in determining the amount of any computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), or the amount of any deficiency attributable to affected items in a proceeding under section 6230(a)(2), for the taxable year in-

volved. Notwithstanding any other law or rule of law pertaining to the period of limitations on the making of assessments, for purposes of the preceding sentence, any adjustment made in accordance with this section shall be taken into account regardless of whether any assessment has been made with respect to such adjustment.

"(2) SPECIAL RULE IN CASE OF COMPUTATIONAL ADJUSTMENT.—In the case of a computational adjustment that is made in connection with a partnership proceeding under this subchapter (other than under this section), the provisions of paragraph (1) shall apply only if the computational adjustment is made within the period prescribed by section 6229 for assessing any tax under subtitle A which is attributable to any partnership item or affected item for the taxable year involved.

"(3) CONVERSION TO DEFICIENCY PROCEEDING.—If—

"(A) after the notice referred to in subsection (a) is mailed to a taxpayer for a taxable year but before the expiration of the period for filing a petition with the Tax Court under subsection (c) (or, if a petition is filed with the Tax Court, before the Tax Court makes a declaration for that taxable year), the treatment of any partnership item for the taxable year is finally determined, or any such item ceases to be a partnership item pursuant to section 6231(b), and

"(B) as a result of that final determination or cessation, a deficiency can be determined with respect to the items that are the subject of the notice of adjustment,

the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition filed in respect of the notice shall be treated as an action brought under section 6213.

"(4) FINALLY DETERMINED.—For purposes of this subsection, the treatment of partnership items shall be treated as finally determined if—

"(A) the Secretary enters into a settlement agreement (within the meaning of section 6224) with the taxpayer regarding such items,

"(B) a notice of final partnership administrative adjustment has been issued and—

"(i) no petition has been filed under section 6226 and the time for doing so has expired, or

"(ii) a petition has been filed under section 6226 and the decision of the court has become final, or

"(C) the period within which any tax attributable to such items may be assessed against the taxpayer has expired.

"(h) SPECIAL RULES IF SECRETARY INCORRECTLY DETERMINES APPLICABLE PROCEDURE.—

"(1) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF ADJUSTMENT.—If the Secretary erroneously determines that subchapter B does not apply to a taxable year of a taxpayer and consistent with that determination timely mails a notice of adjustment to the taxpayer pursuant to subsection (a) of this section, the notice of adjustment shall be treated as a notice of deficiency under section 6212 and any petition that is filed in

respect of the notice shall be treated as an action brought under section 6213.

"(2) SPECIAL RULE IF SECRETARY ERRONEOUSLY MAILS NOTICE OF DEFICIENCY.—If the Secretary erroneously determines that subchapter B applies to a taxable year of a taxpayer and consistent with that determination timely mails a notice of deficiency to the taxpayer pursuant to section 6212, the notice of deficiency shall be treated as a notice of adjustment under subsection (a) and any petition that is filed in respect of the notice shall be treated as an action brought under subsection (c).".

(b) TREATMENT OF PARTNERSHIP ITEMS IN DEFICIENCY PROCEEDINGS.—Section 6211 (defining deficiency) is amended by adding at the end the following new subsection:

"(c) COORDINATION WITH SUBCHAPTER C.—In determining the amount of any deficiency for purposes of this subchapter, adjustments to partnership items shall be made only as provided in subchapter C.".

(c) CLERICAL AMENDMENT.—The table of sections for subchapter C of chapter 63 is amended by adding at the end the following new item:

"Sec. 6234. Declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 1232. PARTNERSHIP RETURN TO BE DETERMINATIVE OF AUDIT PROCEDURES TO BE FOLLOWED.

(a) IN GENERAL.—Section 6231 (relating to definitions and special rules) is amended by adding at the end the following new subsection:

"(g) PARTNERSHIP RETURN TO BE DETERMINATIVE OF WHETHER SUBCHAPTER APPLIES.—

"(1) DETERMINATION THAT SUBCHAPTER APPLIES.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter applies to such partnership for such year but such determination is erroneous, then the provisions of this subchapter are hereby extended to such partnership (and its items) for such taxable year and to partners of such partnership.

"(2) DETERMINATION THAT SUBCHAPTER DOES NOT APPLY.—If, on the basis of a partnership return for a taxable year, the Secretary reasonably determines that this subchapter does not apply to such partnership for such year but such determination is erroneous, then the provisions of this subchapter shall not apply to such partnership (and its items) for such taxable year or to partners of such partnership.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 1233. PROVISIONS RELATING TO STATUTE OF LIMITATIONS.

(a) SUSPENSION OF STATUTE WHERE UNTIMELY PETITION FILED.—Paragraph (1) of section 6229(d) (relating to suspension

where Secretary makes administrative adjustment) is amended by striking all that follows "section 6226" and inserting the following: "(and, if a petition is filed under section 6226 with respect to such administrative adjustment, until the decision of the court becomes final), and".

(b) SUSPENSION OF STATUTE DURING BANKRUPTCY PROCEEDING.—Section 6229 is amended by adding at the end the following new subsection:

"(h) SUSPENSION DURING PENDENCY OF BANKRUPTCY PROCEEDING.—If a petition is filed naming a partner as a debtor in a bankruptcy proceeding under title 11 of the United States Code, the running of the period of limitations provided in this section with respect to such partner shall be suspended—

"(1) for the period during which the Secretary is prohibited by reason of such bankruptcy proceeding from making an assessment, and

"(2) for 60 days thereafter.".

(c) TAX MATTERS PARTNER IN BANKRUPTCY.—Section 6229(b) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2) SPECIAL RULE WITH RESPECT TO DEBTORS IN TITLE 11 CASES.—Notwithstanding any other law or rule of law, if an agreement is entered into under paragraph (1)(B) and the agreement is signed by a person who would be the tax matters partner but for the fact that, at the time that the agreement is executed, the person is a debtor in a bankruptcy proceeding under title 11 of the United States Code, such agreement shall be binding on all partners in the partnership unless the Secretary has been notified of the bankruptcy proceeding in accordance with regulations prescribed by the Secretary.".

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to partnership taxable years with respect to which the period under section 6229 of the Internal Revenue Code of 1986 for assessing tax has not expired on or before the date of the enactment of this Act.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to agreements entered into after the date of the enactment of this Act.

SEC. 1234. EXPANSION OF SMALL PARTNERSHIP EXCEPTION.

(a) IN GENERAL.—Clause (i) of section 6231(a)(1)(B) (relating to exception for small partnerships) is amended to read as follows:

"(i) IN GENERAL.—The term 'partnership' shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner. For purposes of the preceding sentence, a husband and wife (and their estates) shall be treated as 1 partner.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 1235. EXCLUSION OF PARTIAL SETTLEMENTS FROM 1-YEAR LIMITATION ON ASSESSMENT.

(a) IN GENERAL.—Subsection (f) of section 6229 (relating to items becoming nonpartnership items) is amended—

(1) by striking "(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If" and inserting the following:

"(f) SPECIAL RULES.—

"(1) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If",

(2) by moving the text of such subsection 2 ems to the right, and

(3) by adding at the end the following new paragraph:

"(2) SPECIAL RULE FOR PARTIAL SETTLEMENT AGREEMENTS.—If a partner enters into a settlement agreement with the Secretary with respect to the treatment of some of the partnership items in dispute for a partnership taxable year but other partnership items for such year remain in dispute, the period of limitations for assessing any tax attributable to the settled items shall be determined as if such agreement had not been entered into.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to settlements entered into after the date of the enactment of this Act.

SEC. 1236. EXTENSION OF TIME FOR FILING A REQUEST FOR ADMINISTRATIVE ADJUSTMENT.

(a) IN GENERAL.—Section 6227 (relating to administrative adjustment requests) is amended by redesignating subsections (b) and (c) as subsections (c) and (d), respectively, and by inserting after subsection (a) the following new subsection:

"(b) SPECIAL RULE IN CASE OF EXTENSION OF PERIOD OF LIMITATIONS UNDER SECTION 6229.—The period prescribed by subsection (a)(1) for filing of a request for an administrative adjustment shall be extended—

"(1) for the period within which an assessment may be made pursuant to an agreement (or any extension thereof) under section 6229(b), and

"(2) for 6 months thereafter.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 1237. AVAILABILITY OF INNOCENT SPOUSE RELIEF IN CONTEXT OF PARTNERSHIP PROCEEDINGS.

(a) IN GENERAL.—Subsection (a) of section 6230 is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULE IN CASE OF ASSERTION BY PARTNER'S SPOUSE OF INNOCENT SPOUSE RELIEF.—

"(A) Notwithstanding section 6404(b), if the spouse of a partner asserts that section 6013(e) applies with respect to a liability that is attributable to any adjustment to a partnership item, then such spouse may file with the Secretary within 60 days after the notice of computational adjustment is mailed to the spouse a request for abatement of the assessment specified in such notice. Upon receipt of such request, the Secretary shall abate the assessment. Any reassessment of the tax with respect to which an abatement

is made under this subparagraph shall be subject to the deficiency procedures prescribed by subchapter B. The period for making any such reassessment shall not expire before the expiration of 60 days after the date of such abatement.

"(B) If the spouse files a petition with the Tax Court pursuant to section 6213 with respect to the request for abatement described in subparagraph (A), the Tax Court shall only have jurisdiction pursuant to this section to determine whether the requirements of section 6013(e) have been satisfied. For purposes of such determination, the treatment of partnership items under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.

"(C) Rules similar to the rules contained in subparagraphs (B) and (C) of paragraph (2) shall apply for purposes of this paragraph.".

(b) CLAIMS FOR REFUND.—Subsection (c) of section 6230 is amended by adding at the end the following new paragraph:

"(5) RULES FOR SEEKING INNOCENT SPOUSE RELIEF.—

"(A) IN GENERAL.—The spouse of a partner may file a claim for refund on the ground that the Secretary failed to relieve the spouse under section 6013(e) from a liability that is attributable to an adjustment to a partnership item.

"(B) TIME FOR FILING CLAIM.—Any claim under subparagraph (A) shall be filed within 6 months after the day on which the Secretary mails to the spouse the notice of computational adjustment referred to in subsection (a)(3)(A).

"(C) SUIT IF CLAIM NOT ALLOWED.—If the claim under subparagraph (B) is not allowed, the spouse may bring suit with respect to the claim within the period specified in paragraph (3).

"(D) PRIOR DETERMINATIONS ARE BINDING.—For purposes of any claim or suit under this paragraph, the treatment of partnership items under the settlement, the final partnership administrative adjustment, or the decision of the court (whichever is appropriate) that gave rise to the liability in question shall be conclusive.".

(c) TECHNICAL AMENDMENTS.—

(1) Paragraph (1) of section 6230(a) is amended by striking "paragraph (2)" and inserting "paragraph (2) or (3)".

(2) Subsection (a) of section 6503 is amended by striking "section 6230(a)(2)(A)" and inserting "paragraph (2)(A) or (3) of section 6230(a)".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 1238. DETERMINATION OF PENALTIES AT PARTNERSHIP LEVEL.

(a) IN GENERAL.—Section 6221 (relating to tax treatment determined at partnership level) is amended by striking "item" and inserting "item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item)".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (f) of section 6226 is amended—

(A) by striking "relates and" and inserting "relates,", and

(B) by inserting before the period ", and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item".

(2) Clause (i) of section 6230(a)(2)(A) is amended to read as follows:

"(i) affected items which require partner level determinations (other than penalties, additions to tax, and additional amounts that relate to adjustments to partnership items), or".

(3)(A) Subparagraph (A) of section 6230(a)(3), as added by section 1237, is amended by inserting "(including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment)" after "partnership item".

(B) Subparagraph (B) of such section is amended by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

(C) Subparagraph (A) of section 6230(c)(5), as added by section 1237, is amended by inserting before the period "(including any liability for any penalties, additions to tax, or additional amounts relating to such adjustment)".

(D) Subparagraph (D) of section 6230(c)(5), as added by section 1237, is amended by inserting "(and the applicability of any penalties, additions to tax, or additional amounts)" after "partnership items".

(4) Paragraph (1) of section 6230(c) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by adding at the end the following new subparagraph:

"(C) the Secretary erroneously imposed any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.".

(5) So much of subparagraph (A) of section 6230(c)(2) as precedes "shall be filed" is amended to read as follows:

"(A) UNDER PARAGRAPH (1) (A) OR (C).—Any claim under subparagraph (A) or (C) of paragraph (1)".

(6) Paragraph (4) of section 6230(c) is amended by adding at the end the following: "In addition, the determination under the final partnership administrative adjustment or under the decision of the court (whichever is appropriate) concerning the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item shall also be conclusive. Notwithstanding the preceding sentence, the partner shall be allowed to assert any partner level defenses that may apply or to challenge the amount of the computational adjustment.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 1239. PROVISIONS RELATING TO COURT JURISDICTION, ETC.

(a) TAX COURT JURISDICTION TO ENJOIN PREMATURE ASSESSMENTS OF DEFICIENCIES ATTRIBUTABLE TO PARTNERSHIP ITEMS.—Subsection (b) of section 6225 is amended by striking "the proper court." and inserting "the proper court, including the Tax Court. The Tax Court shall have no jurisdiction to enjoin any action or proceeding under this subsection unless a timely petition for a readjustment of the partnership items for the taxable year has been filed and then only in respect of the adjustments that are the subject of such petition.".

(b) JURISDICTION TO CONSIDER STATUTE OF LIMITATIONS WITH RESPECT TO PARTNERS.—Paragraph (1) of section 6226(d) is amended by adding at the end the following new sentence:

"Notwithstanding subparagraph (B), any person treated under subsection (c) as a party to an action shall be permitted to participate in such action (or file a readjustment petition under subsection (b) or paragraph (2) of this subsection) solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired with respect to such person, and the court having jurisdiction of such action shall have jurisdiction to consider such assertion.".

(c) TAX COURT JURISDICTION TO DETERMINE OVERPAYMENTS ATTRIBUTABLE TO AFFECTED ITEMS.—

(1) Paragraph (6) of section 6230(d) is amended by striking "(or an affected item)".

(2) Paragraph (3) of section 6512(b) is amended by adding at the end the following new sentence:

"In the case of a credit or refund relating to an affected item (within the meaning of section 6231(a)(5)), the preceding sentence shall be applied by substituting the periods under sections 6229 and 6230(d) for the periods under section 6511 (b)(2), (c), and (d).".

(d) VENUE ON APPEAL.—

(1) Paragraph (1) of section 7482(b) is amended by striking "or" at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting ", or", and by inserting after subparagraph (E) the following new subparagraph:

"(F) in the case of a petition under section 6234(c)—

"(i) the legal residence of the petitioner if the petitioner is not a corporation, and

"(ii) the place or office applicable under subparagraph (B) if the petitioner is a corporation.".

(2) The last sentence of section 7482(b)(1) is amended by striking "or 6228(a)" and inserting ", 6228(a), or 6234(c)".

(e) OTHER PROVISIONS.—

(1) Subsection (c) of section 7459 is amended by striking "or section 6228(a)" and inserting ", 6228(a), or 6234(c)".

(2) Subsection (o) of section 6501 is amended by adding at the end the following new paragraph:

"(3) For declaratory judgment relating to treatment of items other than partnership items with respect to an oversheltered return, see section 6234.".

(3) Subsection (a) of section 7421, as amended by section 1222, is amended by inserting "6225(b)," after "6213(a),".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to partnership taxable years ending after the date of the enactment of this Act.

SEC. 1240. TREATMENT OF PREMATURE PETITIONS FILED BY NOTICE PARTNERS OR 5-PERCENT GROUPS.

(a) IN GENERAL.—Subsection (b) of section 6226 (relating to judicial review of final partnership administrative adjustments) is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) TREATMENT OF PREMATURE PETITIONS.—If—

"(A) a petition for a readjustment of partnership items for the taxable year involved is filed by a notice partner (or a 5-percent group) during the 90-day period described in subsection (a), and

"(B) no action is brought under paragraph (1) during the 60-day period described therein with respect to such taxable year which is not dismissed,

such petition shall be treated for purposes of paragraph (1) as filed on the last day of such 60-day period.".

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

SEC. 1241. BONDS IN CASE OF APPEALS FROM CERTAIN PROCEEDING.

(a) IN GENERAL.—Subsection (b) of section 7485 (relating to bonds to stay assessment of collection) is amended—

(1) by inserting "penalties," after "any interest,", and

(2) by striking "aggregate of such deficiencies" and inserting "aggregate liability of the parties to the action".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 1242. SUSPENSION OF INTEREST WHERE DELAY IN COMPUTATIONAL ADJUSTMENT RESULTING FROM CERTAIN SETTLEMENTS.

(a) IN GENERAL.—Subsection (c) of section 6601 (relating to interest on underpayment, nonpayment, or extension of time for payment, of tax) is amended by adding at the end the following new sentence: "In the case of a settlement under section 6224(c) which results in the conversion of partnership items to nonpartnership items pursuant to section 6231(b)(1)(C), the preceding sentence shall apply to a computational adjustment resulting from such settlement in the same manner as if such adjustment were a deficiency and such settlement were a waiver referred to in the preceding sentence.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to adjustments with respect to partnership taxable years beginning after the date of the enactment of this Act.

SEC. 1243. SPECIAL RULES FOR ADMINISTRATIVE ADJUSTMENT REQUESTS WITH RESPECT TO BAD DEBTS OR WORTHLESS SECURITIES.

(a) GENERAL RULE.—Section 6227 (relating to administrative adjustment requests) is amended by adding at the end the following new subsection:

"(e) REQUESTS WITH RESPECT TO BAD DEBTS OR WORTHLESS SECURITIES.—In the case of that portion of any request for an administrative adjustment which relates to the deductibility by the partnership under section 166 of a debt as a debt which became worthless, or under section 165(g) of a loss from worthlessness of a security, the period prescribed in subsection (a)(1) shall be 7 years from the last day for filing the partnership return for the year with respect to which such request is made (determined without regard to extensions).".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall take effect as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

(2) TREATMENT OF REQUESTS FILED BEFORE DATE OF ENACTMENT.—In the case of that portion of any request (filed before the date of the enactment of this Act) for an administrative adjustment which relates to the deductibility of a debt as a debt which became worthless or the deductibility of a loss from the worthlessness of a security—

(A) paragraph (2) of section 6227(a) of the Internal Revenue Code of 1986 shall not apply,

(B) the period for filing a petition under section 6228 of the Internal Revenue Code of 1986 with respect to such request shall not expire before the date 6 months after the date of the enactment of this Act, and

(C) such a petition may be filed without regard to whether there was a notice of the beginning of an administrative proceeding or a final partnership administrative adjustment.

PART III—PROVISION RELATING TO CLOSING OF PARTNERSHIP TAXABLE YEAR WITH RESPECT TO DECEASED PARTNER, ETC.

SEC. 1246. CLOSING OF PARTNERSHIP TAXABLE YEAR WITH RESPECT TO DECEASED PARTNER, ETC.

(a) GENERAL RULE.—Subparagraph (A) of section 706(c)(2) (relating to disposition of entire interest) is amended to read as follows:

"(A) DISPOSITION OF ENTIRE INTEREST.—The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise).".

(b) CLERICAL AMENDMENT.—The paragraph heading for paragraph (2) of section 706(c) is amended to read as follows:

"(2) TREATMENT OF DISPOSITIONS.—".

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

Subtitle D—Provisions Relating to Real Estate Investment Trusts

SEC. 1251. CLARIFICATION OF LIMITATION ON MAXIMUM NUMBER OF SHAREHOLDERS.

(a) RULES RELATING TO DETERMINATION OF OWNERSHIP.—

(1) FAILURE TO ISSUE SHAREHOLDER DEMAND LETTER NOT TO DISQUALIFY REIT.—Section 857(a) (relating to requirements applicable to real estate investment trusts) is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(2) SHAREHOLDER DEMAND LETTER REQUIREMENT; PENALTY.—Section 857 (relating to taxation of real estate investment trusts and their beneficiaries) is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) REAL ESTATE INVESTMENT TRUSTS TO ASCERTAIN OWNERSHIP.—

"(1) IN GENERAL.—Each real estate investment trust shall each taxable year comply with regulations prescribed by the Secretary for the purposes of ascertaining the actual ownership of the outstanding shares, or certificates of beneficial interest, of such trust.

"(2) FAILURE TO COMPLY.—

"(A) IN GENERAL.—If a real estate investment trust fails to comply with the requirements of paragraph (1) for a taxable year, such trust shall pay (on notice and demand by the Secretary and in the same manner as tax) a penalty of $25,000.

"(B) INTENTIONAL DISREGARD.—If any failure under paragraph (1) is due to intentional disregard of the requirement under paragraph (1), the penalty under subparagraph (A) shall be $50,000.

"(C) FAILURE TO COMPLY AFTER NOTICE.—The Secretary may require a real estate investment trust to take such actions as the Secretary determines appropriate to ascertain actual ownership if the trust fails to meet the requirements of paragraph (1). If the trust fails to take such actions, the trust shall pay (on notice and demand by the Secretary and in the same manner as tax) an additional penalty equal to the penalty determined under subparagraph (A) or (B), whichever is applicable.

"(D) REASONABLE CAUSE.—No penalty shall be imposed under this paragraph with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.".

(b) COMPLIANCE WITH CLOSELY HELD PROHIBITION.—

(1) IN GENERAL.—Section 856 (defining real estate investment trust) is amended by adding at the end the following new subsection:

"(k) REQUIREMENT THAT ENTITY NOT BE CLOSELY HELD TREATED AS MET IN CERTAIN CASES.—A corporation, trust, or association—

"(1) which for a taxable year meets the requirements of section 857(f)(1), and

"(2) which does not know, or exercising reasonable diligence would not have known, whether the entity failed to meet the requirement of subsection (a)(6),

shall be treated as having met the requirement of subsection (a)(6) for the taxable year.".

(2) CONFORMING AMENDMENT.—Paragraph (6) of section 856(a) is amended by inserting "subject to the provisions of subsection (k)," before "which is not".

SEC. 1252. DE MINIMIS RULE FOR TENANT SERVICES INCOME.

(a) IN GENERAL.—Paragraph (2) of section 856(d) (defining rents from real property) is amended by striking subparagraph (C) and the last sentence and inserting:

"(C) any impermissible tenant service income (as defined in paragraph (7)).".

(b) IMPERMISSIBLE TENANT SERVICE INCOME.—Section 856(d) is amended by adding at the end the following new paragraph:

"(7) IMPERMISSIBLE TENANT SERVICE INCOME.—For purposes of paragraph (2)(C)—

"(A) IN GENERAL.—The term 'impermissible tenant service income' means, with respect to any real or personal property, any amount received or accrued directly or indirectly by the real estate investment trust for—

"(i) services furnished or rendered by the trust to the tenants of such property, or

"(ii) managing or operating such property.

"(B) DISQUALIFICATION OF ALL AMOUNTS WHERE MORE THAN DE MINIMIS AMOUNT.—If the amount described in subparagraph (A) with respect to a property for any taxable year exceeds 1 percent of all amounts received or accrued during such taxable year directly or indirectly by the real estate investment trust with respect to such property, the impermissible tenant service income of the trust with respect to the property shall include all such amounts.

"(C) EXCEPTIONS.—For purposes of subparagraph (A)—

"(i) services furnished or rendered, or management or operation provided, through an independent contractor from whom the trust itself does not derive or receive any income shall not be treated as furnished, rendered, or provided by the trust, and

"(ii) there shall not be taken into account any amount which would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2).

"(D) AMOUNT ATTRIBUTABLE TO IMPERMISSIBLE SERVICES.—For purposes of subparagraph (A), the amount treated as received for any service (or management or operation) shall not be less than 150 percent of the direct cost of the trust in furnishing or rendering the service (or providing the management or operation).

"(E) COORDINATION WITH LIMITATIONS.—For purposes of paragraphs (2) and (3) of subsection (c), amounts de-

scribed in subparagraph (A) shall be included in the gross income of the corporation, trust, or association.”.

SEC. 1253. ATTRIBUTION RULES APPLICABLE TO STOCK OWNERSHIP.

Section 856(d)(5) (relating to constructive ownership of stock) is amended by striking “except that” and all that follows and inserting “except that—

“(A) ‘10 percent’ shall be substituted for ‘50 percent’ in subparagraph (C) of paragraphs (2) and (3) of section 318(a), and

“(B) section 318(a)(3)(A) shall be applied in the case of a partnership by taking into account only partners who own (directly or indirectly) 25 percent or more of the capital interest, or the profits interest, in the partnership.”.

SEC. 1254. CREDIT FOR TAX PAID BY REIT ON RETAINED CAPITAL GAINS.

(a) GENERAL RULE.—Paragraph (3) of section 857(b) (relating to capital gains) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

“(D) TREATMENT BY SHAREHOLDERS OF UNDISTRIBUTED CAPITAL GAINS.—

“(i) Every shareholder of a real estate investment trust at the close of the trust’s taxable year shall include, in computing his long-term capital gains in his return for his taxable year in which the last day of the trust’s taxable year falls, such amount as the trust shall designate in respect of such shares in a written notice mailed to its shareholders at any time prior to the expiration of 60 days after the close of its taxable year (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year), but the amount so includible by any shareholder shall not exceed that part of the amount subjected to tax in subparagraph (A)(ii) which he would have received if all of such amount had been distributed as capital gain dividends by the trust to the holders of such shares at the close of its taxable year.

“(ii) For purposes of this title, every such shareholder shall be deemed to have paid, for his taxable year under clause (i), the tax imposed by subparagraph (A)(ii) on the amounts required by this subparagraph to be included in respect of such shares in computing his long-term capital gains for that year; and such shareholders shall be allowed credit or refund as the case may be, for the tax so deemed to have been paid by him.

“(iii) The adjusted basis of such shares in the hands of the holder shall be increased with respect to the amounts required by this subparagraph to be included in computing his long-term capital gains, by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).

"(iv) In the event of such designation, the tax imposed by subparagraph (A)(ii) shall be paid by the real estate investment trust within 30 days after the close of its taxable year.

"(v) The earnings and profits of such real estate investment trust, and the earnings and profits of any such shareholder which is a corporation, shall be appropriately adjusted in accordance with regulations prescribed by the Secretary.

"(vi) As used in this subparagraph, the terms 'shares' and 'shareholders' shall include beneficial interests and holders of beneficial interests, respectively.".

(b) CONFORMING AMENDMENTS.—

(1) Clause (i) of section 857(b)(7)(A) is amended by striking "subparagraph (B)" and inserting "subparagraph (B) or (D)".

(2) Clause (iii) of section 852(b)(3)(D) is amended by striking "by 65 percent" and all that follows and inserting "by the difference between the amount of such includible gains and the tax deemed paid by such shareholder in respect of such shares under clause (ii).".

SEC. 1255. REPEAL OF 30-PERCENT GROSS INCOME REQUIREMENT.

(a) GENERAL RULE.—Subsection (c) of section 856 (relating to limitations) is amended—

(1) by adding "and" at the end of paragraph (3),

(2) by striking paragraphs (4) and (8), and

(3) by redesignating paragraphs (5), (6), and (7) as paragraphs (4), (5), and (6), respectively.

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (G) of section 856(c)(5), as redesignated by subsection (a), is amended by striking "and such agreement shall be treated as a security for purposes of paragraph (4)(A)".

(2) Paragraph (5) of section 857(b) is amended by striking "section 856(c)(7)" and inserting "section 856(c)(6)".

(3) Subparagraph (C) of section 857(b)(6) is amended by striking "section 856(c)(6)(B)" and inserting "section 856(c)(5)(B)".

SEC. 1256. MODIFICATION OF EARNINGS AND PROFITS RULES FOR DETERMINING WHETHER REIT HAS EARNINGS AND PROFITS FROM NON-REIT YEAR.

Subsection (d) of section 857 is amended by adding at the end the following new paragraph:

"(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (a)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

"(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from the earliest accumulated earnings and profits (other than earnings and profits to which subsection (a)(2)(A) applies) rather than the most recently accumulated earnings and profits, and

"(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(B).".

SEC. 1257. TREATMENT OF FORECLOSURE PROPERTY.

(a) GRACE PERIODS.—

(1) INITIAL PERIOD.—Paragraph (2) of section 856(e) (relating to special rules for foreclosure property) is amended by striking "on the date which is 2 years after the date the trust acquired such property" and inserting "as of the close of the 3d taxable year following the taxable year in which the trust acquired such property".

(2) EXTENSION.—Paragraph (3) of section 856(e) is amended—

(A) by striking "or more extensions" and inserting "extension", and

(B) by striking the last sentence and inserting: "Any such extension shall not extend the grace period beyond the close of the 3d taxable year following the last taxable year in the period under paragraph (2).".

(b) REVOCATION OF ELECTION.—Paragraph (5) of section 856(e) is amended by striking the last sentence and inserting: "A real estate investment trust may revoke any such election for a taxable year by filing the revocation (in the manner provided by the Secretary) on or before the due date (including any extension of time) for filing its return of tax under this chapter for the taxable year. If a trust revokes an election for any property, no election may be made by the trust under this paragraph with respect to the property for any subsequent taxable year.".

(c) CERTAIN ACTIVITIES NOT TO DISQUALIFY PROPERTY.—Paragraph (4) of section 856(e) is amended by adding at the end the following new flush sentence:

"For purposes of subparagraph (C), property shall not be treated as used in a trade or business by reason of any activities of the real estate investment trust with respect to such property to the extent that such activities would not result in amounts received or accrued, directly or indirectly, with respect to such property being treated as other than rents from real property.".

SEC. 1258. PAYMENTS UNDER HEDGING INSTRUMENTS.

Section 856(c)(5)(G) (relating to treatment of certain interest rate agreements), as redesignated by section 1255, is amended to read as follows:

"(G) TREATMENT OF CERTAIN HEDGING INSTRUMENTS.—Except to the extent provided by regulations, any—

"(i) payment to a real estate investment trust under an interest rate swap or cap agreement, option, futures contract, forward rate agreement, or any similar financial instrument, entered into by the trust in a transaction to reduce the interest rate risks with respect to any indebtedness incurred or to be incurred by the trust to acquire or carry real estate assets, and

"(ii) gain from the sale or other disposition of any such investment,

shall be treated as income qualifying under paragraph (2).".

SEC. 1259. EXCESS NONCASH INCOME.

Section 857(e)(2) (relating to determination of amount of excess noncash income) is amended—

(1) by striking subparagraph (B),

(2) by striking the period at the end of subparagraph (C) and inserting a comma,

(3) by redesignating subparagraph (C) (as amended by paragraph (2)) as subparagraph (B), and

(4) by adding at the end the following new subparagraphs:

"(C) the amount (if any) by which—

"(i) the amounts includible in gross income with respect to instruments to which section 860E(a) or 1272 applies, exceed

"(ii) the amount of money and the fair market value of other property received during the taxable year under such instruments, and

"(D) amounts includible in income by reason of cancellation of indebtedness.".

SEC. 1260. PROHIBITED TRANSACTION SAFE HARBOR.

Clause (iii) of section 857(b)(6)(C) (relating to certain sales not to constitute prohibited transactions) is amended by striking "(other than foreclosure property)" in subclauses (I) and (II) and inserting "(other than sales of foreclosure property or sales to which section 1033 applies)".

SEC. 1261. SHARED APPRECIATION MORTGAGES.

(a) BANKRUPTCY SAFE HARBOR.—Section 856(j) (relating to treatment of shared appreciation mortgages) is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

"(4) COORDINATION WITH 4–YEAR HOLDING PERIOD.—

"(A) IN GENERAL.—For purposes of section 857(b)(6)(C), if a real estate investment trust is treated as having sold secured property under paragraph (3)(A), the trust shall be treated as having held such property for at least 4 years if—

"(i) the secured property is sold or otherwise disposed of pursuant to a case under title 11 of the United States Code,

"(ii) the seller is under the jurisdiction of the court in such case, and

"(iii) the disposition is required by the court or is pursuant to a plan approved by the court.

"(B) EXCEPTION.—Subparagraph (A) shall not apply if—

"(i) the secured property was acquired by the seller with the intent to evict or foreclose, or

"(ii) the trust knew or had reason to know that default on the obligation described in paragraph (5)(A) would occur.".

(b) CLARIFICATION OF DEFINITION OF SHARED APPRECIATION PROVISION.—Clause (ii) of section 856(j)(5)(A) is amended by inserting before the period "or appreciation in value as of any specified date".

SEC. 1262. WHOLLY OWNED SUBSIDIARIES.

Section 856(i)(2) (defining qualified REIT subsidiary) is amended by striking "at all times during the period such corporation was in existence".

SEC. 1263. EFFECTIVE DATE.

The amendments made by this part shall apply to taxable years beginning after the date of the enactment of this Act.

Subtitle E—Provisions Relating to Regulated Investment Companies

SEC. 1271. REPEAL OF 30-PERCENT GROSS INCOME LIMITATION.

(a) GENERAL RULE.—Subsection (b) of section 851 (relating to limitations) is amended by striking paragraph (3), by adding "and" at the end of paragraph (2), and by redesignating paragraph (4) as paragraph (3).

(b) TECHNICAL AMENDMENTS.—

(1) The material following paragraph (3) of section 851(b) (as redesignated by subsection (a)) is amended—

(A) by striking out "paragraphs (2) and (3)" and inserting "paragraph (2)", and

(B) by striking out the last sentence thereof.

(2) Subsection (c) of section 851 is amended by striking "subsection (b)(4)" each place it appears (including the heading) and inserting "subsection (b)(3)".

(3) Subsection (d) of section 851 is amended by striking "subsections (b)(4)" and inserting "subsections (b)(3)".

(4) Paragraph (1) of section 851(e) is amended by striking "subsection (b)(4)" and inserting "subsection (b)(3)".

(5) Paragraph (4) of section 851(e) is amended by striking "subsections (b)(4)" and inserting "subsections (b)(3)".

(6) Section 851 is amended by striking subsection (g) and redesignating subsection (h) as subsection (g).

(7) Subsection (g) of section 851 (as redesignated by paragraph (6)) is amended by striking paragraph (3).

(8) Section 817(h)(2) is amended—

(A) by striking "851(b)(4)" in subparagraph (A) and inserting "851(b)(3)", and

(B) by striking "851(b)(4)(A)(i)" in subparagraph (B) and inserting "851(b)(3)(A)(i)".

(9) Section 1092(f)(2) is amended by striking "Except for purposes of section 851(b)(3), the" and inserting "The".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

Subtitle F—Taxpayer Protections

SEC. 1281. REASONABLE CAUSE EXCEPTION FOR CERTAIN PENALTIES.

(a) INFORMATION ON DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—Subsection (g) of section 6652 (relating to information required in connection with deductible employee contributions) is amended by

adding at the end the following new sentence: "No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.".

(b) REPORTS ON STATUS AS QUALIFIED SMALL BUSINESS.—Subsection (k) of section 6652 (relating to failure to make reports required under section 1202) is amended by adding at the end the following new sentence: "No penalty shall be imposed under this subsection on any failure which is shown to be due to reasonable cause and not willful neglect.".

(c) RETURNS OF PERSONAL HOLDING COMPANY TAX BY FOREIGN CORPORATIONS.—Section 6683 (relating to failure of foreign corporation to file return of personal holding company tax) is amended by adding at the end the following new sentence: "No penalty shall be imposed under this section on any failure which is shown to be due to reasonable cause and not willful neglect.".

(d) FAILURE TO MAKE REQUIRED PAYMENTS.—Subparagraph (A) of section 7519(f)(4) is amended by adding at the end the following new sentence: "No penalty shall be imposed under this subparagraph on any failure which is shown to be due to reasonable cause and not willful neglect.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1282. CLARIFICATION OF PERIOD FOR FILING CLAIMS FOR REFUNDS.

(a) IN GENERAL.—Paragraph (3) of section 6512(b) (relating to overpayment determined by Tax Court) is amended by adding at the end the following flush sentence:

> *"In a case described in subparagraph (B) where the date of the mailing of the notice of deficiency is during the third year after the due date (with extensions) for filing the return of tax and no return was filed before such date, the applicable period under subsections (a) and (b)(2) of section 6511 shall be 3 years.".*

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to claims for credit or refund for taxable years ending after the date of the enactment of this Act.

SEC. 1283. REPEAL OF AUTHORITY TO DISCLOSE WHETHER PROSPECTIVE JUROR HAS BEEN AUDITED.

(a) IN GENERAL.—Subsection (h) of section 6103 (relating to disclosure to certain Federal officers and employees for purposes of tax administration, etc.) is amended by striking paragraph (5) and by redesignating paragraph (6) as paragraph (5).

(b) CONFORMING AMENDMENT.—Paragraph (4) of section 6103(p) is amended by striking "(h)(6)" each place it appears and inserting "(h)(5)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to judicial proceedings commenced after the date of the enactment of this Act.

SEC. 1284. CLARIFICATION OF STATUTE OF LIMITATIONS.

(a) IN GENERAL.—Subsection (a) of section 6501 (relating to limitations on assessment and collection) is amended by adding at the end thereof the following new sentence: "For purposes of this

chapter, the term 'return' means the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).".

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

SEC. 1285. AWARDING OF ADMINISTRATIVE COSTS.

(a) RIGHT TO APPEAL TAX COURT DECISION.—Subsection (f) of section 7430 (relating to right of appeal) is amended by adding at the end the following new paragraph:

"(3) APPEAL OF TAX COURT DECISION.—An order of the Tax Court disposing of a petition under paragraph (2) shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.".

(b) PERIOD FOR APPLYING TO IRS FOR COSTS.—Subsection (b) of section 7430 (relating to limitations) is amended by adding at the end the following new paragraph:

"(5) PERIOD FOR APPLYING TO IRS FOR ADMINISTRATIVE COSTS.—An award may be made under subsection (a) by the Internal Revenue Service for reasonable administrative costs only if the prevailing party files an application with the Internal Revenue Service for such costs before the 91st day after the date on which the final decision of the Internal Revenue Service as to the determination of the tax, interest, or penalty is mailed to such party.".

(c) PERIOD FOR PETITIONING OF TAX COURT FOR REVIEW OF DENIAL OF COSTS.—Paragraph (2) of section 7430(f) (relating to right of appeal) is amended—

(1) by striking "appeal to" and inserting "the filing of a petition for review with", and

(2) by adding at the end the following new sentence: "If the Secretary sends by certified or registered mail a notice of such decision to the petitioner, no proceeding in the Tax Court may be initiated under this paragraph unless such petition is filed before the 91st day after the date of such mailing.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to civil actions or proceedings commenced after the date of the enactment of this Act.

TITLE XIII—SIMPLIFICATION PROVISIONS RELATING TO ESTATE AND GIFT TAXES

SEC. 1301. GIFTS TO CHARITIES EXEMPT FROM GIFT TAX FILING REQUIREMENTS.

(a) IN GENERAL.—Section 6019 is amended by striking "or" at the end of paragraph (1), by adding "or" at the end of paragraph (2), and by inserting after paragraph (2) the following new paragraph:

"(3) a transfer with respect to which a deduction is allowed under section 2522 but only if—

"(A)(i) such transfer is of the donor's entire interest in the property transferred, and

"(ii) no other interest in such property is or has been transferred (for less than adequate and full consideration in money or money's worth) from the donor to a person, or for a use, not described in subsection (a) or (b) of section 2522, or

"(B) such transfer is described in section 2522(d),".

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

SEC. 1302. CLARIFICATION OF WAIVER OF CERTAIN RIGHTS OF RECOVERY.

(a) AMENDMENT TO SECTION 2207A.—Paragraph (2) of section 2207A(a) (relating to right of recovery in the case of certain marital deduction property) is amended to read as follows:

"(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.".

(b) AMENDMENT TO SECTION 2207B.—Paragraph (2) of section 2207B(a) (relating to right of recovery where decedent retained interest) is amended to read as follows:

"(2) DECEDENT MAY OTHERWISE DIRECT.—Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.".

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

SEC. 1303. TRANSITIONAL RULE UNDER SECTION 2056A.

(a) GENERAL RULE.—In the case of any trust created under an instrument executed before the date of the enactment of the Revenue Reconciliation Act of 1990, such trust shall be treated as meeting the requirements of paragraph (1) of section 2056A(a) of the Internal Revenue Code of 1986 if the trust instrument requires that all trustees of the trust be individual citizens of the United States or domestic corporations.

(b) EFFECTIVE DATE.—The provisions of subsection (a) shall take effect as if included in the provisions of section 11702(g) of the Revenue Reconciliation Act of 1990.

SEC. 1304. TREATMENT FOR ESTATE TAX PURPOSES OF SHORT-TERM OBLIGATIONS HELD BY NONRESIDENT ALIENS.

(a) IN GENERAL.—Subsection (b) of section 2105 is amended by striking "and" at the end of paragraph (2), by striking the period at the end of paragraph (3) and inserting ", and", and by inserting after paragraph (3) the following new paragraph:

"(4) obligations which would be original issue discount obligations as defined in section 871(g)(1) but for subparagraph (B)(i) thereof, if any interest thereon (were such interest received by the decedent at the time of his death) would not be effectively

connected with the conduct of a trade or business within the United States.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after the date of the enactment of this Act.

SEC. 1305. CERTAIN REVOCABLE TRUSTS TREATED AS PART OF ESTATE.

(a) IN GENERAL.—Subpart A of part I of subchapter J (relating to estates, trusts, beneficiaries, and decedents) is amended by adding at the end the following new section:

"SEC. 646. CERTAIN REVOCABLE TRUSTS TREATED AS PART OF ESTATE.

"(a) GENERAL RULE.—For purposes of this subtitle, if both the executor (if any) of an estate and the trustee of a qualified revocable trust elect the treatment provided in this section, such trust shall be treated and taxed as part of such estate (and not as a separate trust) for all taxable years of the estate ending after the date of the decedent's death and before the applicable date.

"(b) DEFINITIONS.—For purposes of subsection (a)—

"(1) QUALIFIED REVOCABLE TRUST.—The term 'qualified revocable trust' means any trust (or portion thereof) which was treated under section 676 as owned by the decedent of the estate referred to in subsection (a) by reason of a power in the grantor (determined without regard to section 672(e)).

"(2) APPLICABLE DATE.—The term 'applicable date' means—

"(A) if no return of tax imposed by chapter 11 is required to be filed, the date which is 2 years after the date of the decedent's death, and

"(B) if such a return is required to be filed, the date which is 6 months after the date of the final determination of the liability for tax imposed by chapter 11.

"(c) ELECTION.—The election under subsection (a) shall be made not later than the time prescribed for filing the return of tax imposed by this chapter for the first taxable year of the estate (determined with regard to extensions) and, once made, shall be irrevocable.".

(b) COMPARABLE TREATMENT UNDER GENERATION-SKIPPING TAX.—Paragraph (1) of section 2652(b) is amended by adding at the end the following new sentence: "Such term shall not include any trust during any period the trust is treated as part of an estate under section 646.".

(c) CLERICAL AMENDMENT.—The table of sections for such subpart A is amended by adding at the end the following new item:

"Sec. 646. Certain revocable trusts treated as part of estate.".

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

SEC. 1306. DISTRIBUTIONS DURING FIRST 65 DAYS OF TAXABLE YEAR OF ESTATE.

(a) IN GENERAL.—Subsection (b) of section 663 (relating to distributions in first 65 days of taxable year) is amended by inserting "an estate or" before "a trust" each place it appears.

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 663(b) is amended by striking "the fiduciary of such trust" and inserting "the executor of such estate or the fiduciary of such trust (as the case may be)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1307. SEPARATE SHARE RULES AVAILABLE TO ESTATES.

(a) IN GENERAL.—Subsection (c) of section 663 (relating to separate shares treated as separate trusts) is amended—

(1) by inserting before the last sentence the following new sentence: "Rules similar to the rules of the preceding provisions of this subsection shall apply to treat substantially separate and independent shares of different beneficiaries in an estate having more than 1 beneficiary as separate estates.", and

(2) by inserting "or estates" after "trusts" in the last sentence.

(b) CONFORMING AMENDMENT.—The subsection heading of section 663(c) is amended by inserting "ESTATES OR" before "TRUSTS".

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

SEC. 1308. EXECUTOR OF ESTATE AND BENEFICIARIES TREATED AS RELATED PERSONS FOR DISALLOWANCE OF LOSSES, ETC.

(a) DISALLOWANCE OF LOSSES.—Subsection (b) of section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers) is amended by striking "or" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting "; or", and by adding at the end the following new paragraph:

"(13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.".

(b) ORDINARY INCOME FROM GAIN FROM SALE OF DEPRECIABLE PROPERTY.—Subsection (b) of section 1239 is amended by striking the period at the end of paragraph (2) and inserting ", and" and by adding at the end the following new paragraph:

"(3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1309. TREATMENT OF FUNERAL TRUSTS.

(a) IN GENERAL.—Subpart F of part I of subchapter J of chapter 1 is amended by adding at the end the following new section:

"SEC. 685. TREATMENT OF FUNERAL TRUSTS.

"(a) IN GENERAL.—In the case of a qualified funeral trust—

"(1) subparts B, C, D, and E shall not apply, and

"(2) no deduction shall be allowed by section 642(b).

"(b) QUALIFIED FUNERAL TRUST.—For purposes of this subsection, the term 'qualified funeral trust' means any trust (other than a foreign trust) if—

"(1) the trust arises as a result of a contract with a person engaged in the trade or business of providing funeral or burial services or property necessary to provide such services,

"(2) the sole purpose of the trust is to hold, invest, and reinvest funds in the trust and to use such funds solely to make payments for such services or property for the benefit of the beneficiaries of the trust,

"(3) the only beneficiaries of such trust are individuals with respect to whom such services or property are to be provided at their death under contracts described in paragraph (1),

"(4) the only contributions to the trust are contributions by or for the benefit of such beneficiaries,

"(5) the trustee elects the application of this subsection, and

"(6) the trust would (but for the election described in paragraph (5)) be treated as owned under subpart E by the purchasers of the contracts described in paragraph (1).

"(c) DOLLAR LIMITATION ON CONTRIBUTIONS.—

"(1) IN GENERAL.—The term 'qualified funeral trust' shall not include any trust which accepts aggregate contributions by or for the benefit of an individual in excess of $7,000.

"(2) RELATED TRUSTS.—For purposes of paragraph (1), all trusts having trustees which are related persons shall be treated as 1 trust. For purposes of the preceding sentence, persons are related if—

"(A) the relationship between such persons is described in section 267 or 707(b),

"(B) such persons are treated as a single employer under subsection (a) or (b) of section 52, or

"(C) the Secretary determines that treating such persons as related is necessary to prevent avoidance of the purposes of this section.

"(3) INFLATION ADJUSTMENT.—In the case of any contract referred to in subsection (b)(1) which is entered into during any calendar year after 1998, the dollar amount referred to paragraph (1) shall 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 such calendar year, by substituting 'calendar year 1997' for 'calendar year 1992' in subparagraph (B) thereof.

If any dollar amount after being increased under the preceding sentence is not a multiple of $100, such dollar amount shall be rounded to the nearest multiple of $100.

"(d) APPLICATION OF RATE SCHEDULE.—Section 1(e) shall be applied to each qualified funeral trust by treating each beneficiary's interest in each such trust as a separate trust.

"(e) TREATMENT OF AMOUNTS REFUNDED TO PURCHASER ON CANCELLATION.—No gain or loss shall be recognized to a purchaser of a contract described in subsection (b)(1) by reason of any payment from such trust to such purchaser by reason of cancellation of such contract. If any payment referred to in the preceding sentence consists of property other than money, the basis of such property in the hands of such purchaser shall be the same as the trust's basis in such property immediately before the payment.

"(f) SIMPLIFIED REPORTING.—The Secretary may prescribe rules for simplified reporting of all trusts having a single trustee.".

(b) CLERICAL AMENDMENT.—The table of sections for subpart F of part I of subchapter J of chapter 1 is amended by adding at the end the following new item:

"Sec. 685. Treatment of funeral trusts.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

SEC. 1310. ADJUSTMENTS FOR GIFTS WITHIN 3 YEARS OF DECEDENT'S DEATH.

(a) GENERAL RULE.—Section 2035 is amended to read as follows:

"SEC. 2035. ADJUSTMENTS FOR CERTAIN GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH.

"(a) INCLUSION OF CERTAIN PROPERTY IN GROSS ESTATE.—If—

"(1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and

"(2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under section 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of his death,

the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

"(b) INCLUSION OF GIFT TAX ON GIFTS MADE DURING 3 YEARS BEFORE DECEDENT'S DEATH.—The amount of the gross estate (determined without regard to this subsection) shall be increased by the amount of any tax paid under chapter 12 by the decedent or his estate on any gift made by the decedent or his spouse during the 3-year period ending on the date of the decedent's death.

"(c) OTHER RULES RELATING TO TRANSFERS WITHIN 3 YEARS OF DEATH.—

"(1) IN GENERAL.—For purposes of—

"(A) section 303(b) (relating to distributions in redemption of stock to pay death taxes),

"(B) section 2032A (relating to special valuation of certain farms, etc., real property), and

"(C) subchapter C of chapter 64 (relating to lien for taxes),

the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

"(2) COORDINATION WITH SECTION 6166.—An estate shall be treated as meeting the 35 percent of adjusted gross estate requirement of section 6166(a)(1) only if the estate meets such requirement both with and without the application of paragraph (1).

"(3) MARITAL AND SMALL TRANSFERS.—Paragraph (1) shall not apply to any transfer (other than a transfer with respect to

a life insurance policy) made during a calendar year to any donee if the decedent was not required by section 6019 (other than by reason of section 6019(2)) to file any gift tax return for such year with respect to transfers to such donee.

"(d) EXCEPTION.—Subsection (a) shall not apply to any bona fide sale for an adequate and full consideration in money or money's worth.

"(e) TREATMENT OF CERTAIN TRANSFERS FROM REVOCABLE TRUSTS.—For purposes of this section and section 2038, any transfer from any portion of a trust during any period that such portion was treated under section 676 as owned by the decedent by reason of a power in the grantor (determined without regard to section 672(e)) shall be treated as a transfer made directly by the decedent.".

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter A of chapter 11 is amended by striking "gifts" in the item relating to section 2035 and inserting "certain gifts".

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

SEC. 1311. CLARIFICATION OF TREATMENT OF SURVIVOR ANNUITIES UNDER QUALIFIED TERMINABLE INTEREST RULES.

(a) IN GENERAL.—Subparagraph (C) of section 2056(b)(7) is amended by inserting "(or, in the case of an interest in an annuity arising under the community property laws of a State, included in the gross estate of the decedent under section 2033)" after "section 2039".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after the date of the enactment of this Act.

SEC. 1312. TREATMENT UNDER QUALIFIED DOMESTIC TRUST RULES OF FORMS OF OWNERSHIP WHICH ARE NOT TRUSTS.

(a) IN GENERAL.—Subsection (c) of section 2056A (defining qualified domestic trust) is amended by adding at the end the following new paragraph:

"(3) TRUST.—To the extent provided in regulations prescribed by the Secretary, the term 'trust' includes other arrangements which have substantially the same effect as a trust.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after the date of the enactment of this Act.

SEC. 1313. OPPORTUNITY TO CORRECT CERTAIN FAILURES UNDER SECTION 2032A.

(a) GENERAL RULE.—Paragraph (3) of section 2032A(d) (relating to modification of election and agreement to be permitted) is amended to read as follows:

"(3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but—

"(A) the notice of election, as filed, does not contain all required information, or

"(B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,

the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.".

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

SEC. 1314. AUTHORITY TO WAIVE REQUIREMENT OF UNITED STATES TRUSTEE FOR QUALIFIED DOMESTIC TRUSTS.

(a) IN GENERAL.—Subparagraph (A) of section 2056A(a)(1) is amended by inserting "except as provided in regulations prescribed by the Secretary," before "requires".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after the date of the enactment of this Act.

TITLE XIV—SIMPLIFICATION PROVISIONS RELATING TO EXCISE TAXES, TAX-EXEMPT BONDS, AND OTHER MATTERS

Subtitle A—Excise Tax Simplification

PART I—EXCISE TAXES ON HEAVY TRUCKS AND LUXURY CARS

SEC. 1401. INCREASE IN DE MINIMIS LIMIT FOR AFTER-MARKET ALTERATIONS FOR HEAVY TRUCKS AND LUXURY CARS.

(a) IN GENERAL.—Sections 4003(a)(3)(C) and 4051(b)(2)(B) (relating to exceptions) are each amended by striking "$200" and inserting "$1,000".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to installations on vehicles sold after the date of the enactment of this Act.

SEC. 1402. CREDIT FOR TIRE TAX IN LIEU OF EXCLUSION OF VALUE OF TIRES IN COMPUTING PRICE.

(a) IN GENERAL.—Subsection (e) of section 4051 is amended to read as follows:

"(e) CREDIT AGAINST TAX FOR TIRE TAX.—If—

"(1) tires are sold on or in connection with the sale of any article, and

"(2) tax is imposed by this subchapter on the sale of such tires,

there shall be allowed as a credit against the tax imposed by this subchapter an amount equal to the tax (if any) imposed by section 4071 on such tires.".

(b) CONFORMING AMENDMENT.—Subparagraph (B) of section 4052(b)(1) is amended by striking clause (iii), by adding "and" at the end of clause (ii), and by redesignating clause (iv) as clause (iii).

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1998.

PART II—PROVISIONS RELATED TO DISTILLED SPIRITS, WINES, AND BEER

SEC. 1411. CREDIT OR REFUND FOR IMPORTED BOTTLED DISTILLED SPIRITS RETURNED TO DISTILLED SPIRITS PLANT.

(a) IN GENERAL.—Section 5008(c)(1) (relating to distilled spirits returned to bonded premises) is amended by striking "withdrawn from bonded premises on payment or determination of tax" and inserting "on which tax has been determined or paid".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1412. AUTHORITY TO CANCEL OR CREDIT EXPORT BONDS WITHOUT SUBMISSION OF RECORDS.

(a) IN GENERAL.—Section 5175(c) (relating to cancellation of credit of export bonds) is amended by striking "on the submission of" and all that follows and inserting "if there is such proof of exportation as the Secretary may by regulations require.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1413. REPEAL OF REQUIRED MAINTENANCE OF RECORDS ON PREMISES OF DISTILLED SPIRITS PLANT.

(a) IN GENERAL.—Section 5207(c) (relating to preservation and inspection) is amended by striking "shall be kept on the premises where the operations covered by the record are carried on and".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1414. FERMENTED MATERIAL FROM ANY BREWERY MAY BE RECEIVED AT A DISTILLED SPIRITS PLANT.

(a) IN GENERAL.—Section 5222(b)(2) (relating to receipt) is amended to read as follows:

"(2) beer conveyed without payment of tax from brewery premises, beer which has been lawfully removed from brewery premises upon determination of tax, or".

(b) CLARIFICATION OF AUTHORITY TO PERMIT REMOVAL OF BEER WITHOUT PAYMENT OF TAX FOR USE AS DISTILLING MATERIAL.—Section 5053 (relating to exemptions) is amended by redesignating subsection (f) as subsection (i) and by inserting after subsection (e) the following new subsection:

"(f) REMOVAL FOR USE AS DISTILLING MATERIAL.—Subject to such regulations as the Secretary may prescribe, beer may be removed from a brewery without payment of tax to any distilled spirits plant for use as distilling material.".

(c) CLARIFICATION OF REFUND AND CREDIT OF TAX.—Section 5056 (relating to refund and credit of tax, or relief from liability) is amended—

(1) by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) BEER RECEIVED AT A DISTILLED SPIRITS PLANT.—Any tax paid by any brewer on beer produced in the United States may be refunded or credited to the brewer, without interest, or if the tax has not been paid, the brewer may be relieved of liability therefor, under regulations as the Secretary may prescribe, if such beer is received on the bonded premises of a distilled spirits plant pursuant to the provisions of section 5222(b)(2), for use in the production of distilled spirits.", and

(2) by striking "or rendering unmerchantable" in subsection (d) (as so redesignated) and inserting "rendering unmerchantable, or receipt on the bonded premises of a distilled spirits plant".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1415. REPEAL OF REQUIREMENT FOR WHOLESALE DEALERS IN LIQUORS TO POST SIGN.

(a) IN GENERAL.—Section 5115 (relating to sign required on premises) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Section 5681(a) is amended by striking ", and every wholesale dealer in liquors," and by striking "section 5115(a) or".

(2) Section 5681(c) is amended—

(A) by striking "or wholesale liquor establishment, on which no sign required by section 5115(a) or" and inserting "on which no sign required by", and

(B) by striking "or wholesale liquor establishment, or who" and inserting "or who".

(3) The table of sections for subpart D of part II of subchapter A of chapter 51 is amended by striking the item relating to section 5115.

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1416. REFUND OF TAX TO WINE RETURNED TO BOND NOT LIMITED TO UNMERCHANTABLE WINE.

(a) IN GENERAL.—Section 5044(a) (relating to refund of tax on unmerchantable wine) is amended by striking "as unmerchantable".

(b) CONFORMING AMENDMENTS.—

(1) Section 5361 is amended by striking "unmerchantable".

*(2) The section heading for section 5044 is amended by striking "**UNMERCHANTABLE**".*

(3) The item relating to section 5044 in the table of sections for subpart C of part I of subchapter A of chapter 51 is amended by striking "unmerchantable".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1417. USE OF ADDITIONAL AMELIORATING MATERIAL IN CERTAIN WINES.

(a) IN GENERAL.—Section 5384(b)(2)(D) (relating to ameliorated fruit and berry wines) is amended by striking "loganberries, currants, or gooseberries," and inserting "any fruit or berry with a natural fixed acid of 20 parts per thousand or more (before any correction of such fruit or berry)".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1418. DOMESTICALLY PRODUCED BEER MAY BE WITHDRAWN FREE OF TAX FOR USE OF FOREIGN EMBASSIES, LEGATIONS, ETC.

(a) IN GENERAL.—Section 5053 (relating to exemptions), as amended by section 1414(b), is amended by inserting after subsection (f) the following new subsection:

"(g) REMOVALS FOR USE OF FOREIGN EMBASSIES, LEGATIONS, ETC.—

"(1) IN GENERAL.—Subject to such regulations as the Secretary may prescribe—

"(A) beer may be withdrawn from the brewery without payment of tax for transfer to any customs bonded warehouse for entry pending withdrawal therefrom as provided in subparagraph (B), and

"(B) beer entered into any customs bonded warehouse under subparagraph (A) may be withdrawn for consumption in the United States by, and for the official and family use of, such foreign governments, organizations, and individuals as are entitled to withdraw imported beer from such warehouses free of tax.

Beer transferred to any customs bonded warehouse under subparagraph (A) shall be entered, stored, and accounted for in such warehouse under such regulations and bonds as the Secretary may prescribe, and may be withdrawn therefrom by such governments, organizations, and individuals free of tax under the same conditions and procedures as imported beer.

"(2) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (2) and (3) of section 5362(e) shall apply for purposes of this subsection.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1419. BEER MAY BE WITHDRAWN FREE OF TAX FOR DESTRUCTION.

(a) IN GENERAL.—Section 5053 (relating to exemptions), as amended by section 1418(a), is amended by inserting after subsection (g) the following new subsection:

"(h) REMOVALS FOR DESTRUCTION.—Subject to such regulations as the Secretary may prescribe, beer may be removed from the brewery without payment of tax for destruction.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1420. AUTHORITY TO ALLOW DRAWBACK ON EXPORTED BEER WITHOUT SUBMISSION OF RECORDS.

(a) IN GENERAL.—The first sentence of section 5055 (relating to drawback of tax on beer) is amended by striking "found to have been paid" and all that follows and inserting "paid on such beer if there is such proof of exportation as the Secretary may by regulations require.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1421. TRANSFER TO BREWERY OF BEER IMPORTED IN BULK WITHOUT PAYMENT OF TAX.

(a) IN GENERAL.—Part II of subchapter G of chapter 51 is amended by adding at the end the following new section:

"SEC. 5418. BEER IMPORTED IN BULK.

"Beer imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers to the premises of a brewery without payment of the internal revenue tax imposed on such beer. The proprietor of a brewery to which such beer is transferred shall become liable for the tax on the beer withdrawn from customs custody under this section upon release of the beer from customs custody, and the importer, or the person bringing such beer into the United States, shall thereupon be relieved of the liability for such tax.".

(b) CLERICAL AMENDMENT.—The table of sections for such part II is amended by adding at the end the following new item:

"Sec. 5418. Beer imported in bulk.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

SEC. 1422. TRANSFER TO BONDED WINE CELLARS OF WINE IMPORTED IN BULK WITHOUT PAYMENT OF TAX.

(a) IN GENERAL.—Part II of subchapter F of chapter 51 is amended by inserting after section 5363 the following new section:

"SEC. 5364. WINE IMPORTED IN BULK.

"Wine imported or brought into the United States in bulk containers may, under such regulations as the Secretary may prescribe, be withdrawn from customs custody and transferred in such bulk containers to the premises of a bonded wine cellar without payment of the internal revenue tax imposed on such wine. The proprietor of a bonded wine cellar to which such wine is transferred shall become liable for the tax on the wine withdrawn from customs custody under this section upon release of the wine from customs custody, and the importer, or the person bringing such wine into the United States, shall thereupon be relieved of the liability for such tax.".

(b) CLERICAL AMENDMENT.—The table of sections for such part II is amended by inserting after the item relating to section 5363 the following new item:

"Sec. 5364. Wine imported in bulk.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the 1st day of the 1st calendar quarter that begins at least 180 days after the date of the enactment of this Act.

PART III—OTHER EXCISE TAX PROVISIONS

SEC. 1431. AUTHORITY TO GRANT EXEMPTIONS FROM REGISTRATION REQUIREMENTS.

(a) IN GENERAL.—Section 4222(b)(2) (relating to export) is amended—

(1) by striking "in the case of any sale or resale for export,", and

(2) by striking "EXPORT" and inserting "UNDER REGULATIONS".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect on the date of the enactment of this Act.

SEC. 1432. REPEAL OF EXPIRED PROVISIONS.

(a) PIGGY-BACK TRAILERS.—Section 4051 (relating to imposition of tax on heavy trucks and trailers sold at retail) is amended by striking subsection (d) and by redesignating subsection (e) as subsection (d).

(b) DEEP SEABED MINING.—

(1) IN GENERAL.—Subchapter F of chapter 36 (relating to tax on removal of hard mineral resources from deep seabed) is hereby repealed.

(2) CONFORMING AMENDMENT.—The table of subchapters for chapter 36 is amended by striking the item relating to subchapter F.

(c) OZONE-DEPLETING CHEMICALS.—

(1) Paragraph (1) of section 4681(b) is amended by striking subparagraphs (B) and (C) and inserting the following new subparagraph:

"(B) BASE TAX AMOUNT.—The base tax amount for purposes of subparagraph (A) with respect to any sale or use during any calendar year after 1995 shall be $5.35 increased by 45 cents for each year after 1995.".

(2) Subsection (g) of section 4682 is amended to read as follows:

"(g) CHEMICALS USED AS PROPELLANTS IN METERED-DOSE INHALERS.—

"(1) EXEMPTION FROM TAX.—

"(A) IN GENERAL.—No tax shall be imposed by section 4681 on—

"(i) any use of any substance as a propellant in metered-dose inhalers, or

"(ii) any qualified sale by the manufacturer, producer, or importer of any substance.

"(B) QUALIFIED SALE.—For purposes of subparagraph (A), the term 'qualified sale' means any sale by the manufacturer, producer, or importer of any substance—

"(i) for use by the purchaser as a propellant in metered dose inhalers, or

"(ii) for resale by the purchaser to a 2d purchaser for such use by the 2d purchaser.

The preceding sentence shall apply only if the manufacturer, producer, and importer, and the 1st and 2d purchasers (if any) meet such registration requirements as may be prescribed by the Secretary.

“(2) OVERPAYMENTS.—If any substance on which tax was paid under this subchapter is used by any person as a propellant in metered-dose inhalers, credit or refund without interest shall be allowed to such person in an amount equal to the tax so paid. Amounts payable under the preceding sentence with respect to uses during the taxable year shall be treated as described in section 34(a) for such year unless claim thereof has been timely filed under this paragraph.”.

SEC. 1433. SIMPLIFICATION OF IMPOSITION OF EXCISE TAX ON ARROWS.

(a) IN GENERAL.—Subsection (b) of section 4161 (relating to imposition of tax) is amended to read as follows:

“(b) BOWS AND ARROWS, ETC.—

“(1) BOWS.—

“(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any bow which has a draw weight of 10 pounds or more, a tax equal to 11 percent of the price for which so sold.

“(B) PARTS AND ACCESSORIES.—There is hereby imposed upon the sale by the manufacturer, producer, or importer—

“(i) of any part of accessory suitable for inclusion in or attachment to a bow described in subparagraph (A), and

“(ii) of any quiver suitable for use with arrows described in paragraph (2), a tax equivalent to 11 percent of the price for which so sold.

“(2) ARROWS.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any shaft, point, nock, or vane of a type used in the manufacture of any arrow which after its assembly—

“(A) measures 18 inches overall or more in length, or

“(B) measures less than 18 inches overall in length but is suitable for use with a bow described in paragraph (1)(A),

a tax equal to 12.4 percent of the price for which so sold.

“(3) COORDINATION WITH SUBSECTION (a).—No tax shall be imposed under this subsection with respect to any article taxable under subsection (a).”.

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to articles sold by the manufacturer, producer, or importer after September 30 1997.

SEC. 1434. MODIFICATIONS TO RETAIL TAX ON HEAVY TRUCKS.

(a) CERTAIN REPAIRS AND MODIFICATIONS NOT TREATED AS MANUFACTURE.—Section 4052 is amended by redesignating the subsection defining a long-term lease as subsection (e) and by adding at the end the following new subsection:

“(f) CERTAIN REPAIRS AND MODIFICATIONS NOT TREATED AS MANUFACTURE.—

"(1) IN GENERAL.—An article described in section 4051(a)(1) shall not be treated as manufactured or produced solely by reason of repairs or modifications to the article (including any modification which changes the transportation function of the article or restores a wrecked article to a functional condition) if the cost of such repairs and modifications does not exceed 75 percent of the retail price of a comparable new article.

"(2) EXCEPTION.—Paragraph (1) shall not apply if the article (as repaired or modified) would, if new, be taxable under section 4051 and the article when new was not taxable under this section or the corresponding provision of prior law.".

(b) SIMPLIFICATION OF CERTIFICATION PROCEDURES WITH RESPECT TO SALES OF TAXABLE ARTICLES.—

(1) REPEAL OF REGISTRATION REQUIREMENT.—Subsection (d) of section 4052 is amended by striking "rules of—" and all that follows through "shall apply" and inserting "rules of subsections (c) and (d) of section 4216 (relating to partial payments) shall apply".

(2) REQUIREMENT TO MODIFY REGULATIONS.—Section 4052 is amended by adding at the end the following new subsection:

"(g) REGULATIONS.—The Secretary shall prescribe regulations which permit, in lieu of any other certification, persons who are purchasing articles taxable under this subchapter for resale or leasing in a long-term lease to execute a statement (made under penalties of perjury) on the sale invoice that such sale is for resale. The Secretary shall not impose any registration requirement as a condition of using such procedure.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1998.

SEC. 1435. SKYDIVING FLIGHTS EXEMPT FROM TAX ON TRANSPORTATION OF PERSONS BY AIR.

(a) IN GENERAL.—Section 4261 (relating to imposition of tax on transportation of persons by air), as previously amended by this Act, is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) EXEMPTION FOR SKYDIVING USES.—No tax shall be imposed by this section or section 4271 on any air transportation exclusively for the purpose of skydiving.".

(b) TRANSPORTATION TREATED AS NONCOMMERCIAL AVIATION.—The last sentence of section 4041(c)(2) is amended by inserting before the period "or by reason of section 4261(h)".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to amounts paid after September 30, 1997.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall take effect on October 1, 1997.

SEC. 1436. ALLOWANCE OR CREDIT OF REFUND FOR TAX-PAID AVIATION FUEL PURCHASED BY REGISTERED PRODUCER OF AVIATION FUEL.

(a) IN GENERAL.—Section 4091 (relating to aviation fuel) is amended by adding at the end the following new subsection:

"(d) REFUND OF TAX-PAID AVIATION FUEL TO REGISTERED PRODUCER OF FUEL.—If—

"(1) a producer of aviation fuel is registered under section 4101, and

"(2) such producer establishes to the satisfaction of the Secretary that a prior tax was paid (and not credited or refunded) on aviation fuel held by such producer,

then an amount equal to the tax so paid shall be allowed as a refund (without interest) to such producer in the same manner as if it were an overpayment of tax imposed by this section.".

(b) CONFORMING AMENDMENT.—The last sentence of section 6416(d) is amended by inserting before the period "or to the tax imposed by section 4091 in the case of refunds described in section 4091(d)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to fuel acquired by the producer after September 30, 1997.

Subtitle B—Tax-Exempt Bond Provisions

SEC. 1441. REPEAL OF $100,000 LIMITATION ON UNSPENT PROCEEDS UNDER 1-YEAR EXCEPTION FROM REBATE.

Subclause (I) of section 148(f)(4)(B)(ii) (relating to additional period for certain bonds) is amended by striking "the lesser of 5 percent of the proceeds of the issue or $100,000" and inserting "5 percent of the proceeds of the issue".

SEC. 1442. EXCEPTION FROM REBATE FOR EARNINGS ON BONA FIDE DEBT SERVICE FUND UNDER CONSTRUCTION BOND RULES.

Subparagraph (C) of section 148(f)(4) is amended by adding at the end the following new clause:

"(xvii) TREATMENT OF BONA FIDE DEBT SERVICE FUNDS.—If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue.".

SEC. 1443. REPEAL OF DEBT SERVICE-BASED LIMITATION ON INVESTMENT IN CERTAIN NONPURPOSE INVESTMENTS.

Subsection (d) of section 148 (relating to special rules for reasonably required reserve or replacement fund) is amended by striking paragraph (3).

SEC. 1444. REPEAL OF EXPIRED PROVISIONS.

(a) Paragraph (2) of section 148(c) is amended by striking subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively.

(b) Paragraph (4) of section 148(f) is amended by striking subparagraph (E).

SEC. 1445. EFFECTIVE DATE.

The amendments made by this subtitle shall apply to bonds issued after the date of the enactment of this Act.

Subtitle C—Tax Court Procedures

SEC. 1451. OVERPAYMENT DETERMINATIONS OF TAX COURT.

(a) APPEAL OF ORDER.—Paragraph (2) of section 6512(b) (relating to jurisdiction to enforce) is amended by adding at the end the following new sentence: "An order of the Tax Court disposing of a motion under this paragraph shall be reviewable in the same manner as a decision of the Tax Court, but only with respect to the matters determined in such order.".

(b) DENIAL OF JURISDICTION REGARDING CERTAIN CREDITS AND REDUCTIONS.—Subsection (b) of section 6512 (relating to overpayment determined by Tax Court) is amended by adding at the end the following new paragraph:

"(4) DENIAL OF JURISDICTION REGARDING CERTAIN CREDITS AND REDUCTIONS.—The Tax Court shall have no jurisdiction under this subsection to restrain or review any credit or reduction made by the Secretary under section 6402.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1452. REDETERMINATION OF INTEREST PURSUANT TO MOTION.

(a) IN GENERAL.—Subsection (c) of section 7481 (relating to jurisdiction over interest determinations) is amended to read as follows:

"(c) JURISDICTION OVER INTEREST DETERMINATIONS.—

"(1) IN GENERAL.—Notwithstanding subsection (a), if, within 1 year after the date the decision of the Tax Court becomes final under subsection (a) in a case to which this subsection applies, the taxpayer files a motion in the Tax Court for a redetermination of the amount of interest involved, then the Tax Court may reopen the case solely to determine whether the taxpayer has made an overpayment of such interest or the Secretary has made an underpayment of such interest and the amount thereof.

"(2) CASES TO WHICH THIS SUBSECTION APPLIES.—This subsection shall apply where—

"(A)(i) an assessment has been made by the Secretary under section 6215 which includes interest as imposed by this title, and

"(ii) the taxpayer has paid the entire amount of the deficiency plus interest claimed by the Secretary, and

"(B) the Tax Court finds under section 6512(b) that the taxpayer has made an overpayment.

"(3) SPECIAL RULES.—If the Tax Court determines under this subsection that the taxpayer has made an overpayment of interest or that the Secretary has made an underpayment of interest, then that determination shall be treated under section 6512(b)(1) as a determination of an overpayment of tax. An order of the Tax Court redetermining interest, when entered upon the records of the court, shall be reviewable in the same manner as a decision of the Tax Court.".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1453. APPLICATION OF NET WORTH REQUIREMENT FOR AWARDS OF LITIGATION COSTS.

(a) IN GENERAL.—Paragraph (4) of section 7430(c) (defining prevailing party) is amended by adding at the end thereof the following new subparagraph:

"(D) SPECIAL RULES FOR APPLYING NET WORTH REQUIREMENT.—In applying the requirements of section 2412(d)(2)(B) of title 28, United States Code, for purposes of subparagraph (A)(iii) of this paragraph—

"(i) the net worth limitation in clause (i) of such section shall apply to—

"(I) an estate but shall be determined as of the date of the decedent's death, and

"(II) a trust but shall be determined as of the last day of the taxable year involved in the proceeding, and

"(ii) individuals filing a joint return shall be treated as separate individuals for purposes of clause (i) of such section.".

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

SEC. 1454. PROCEEDINGS FOR DETERMINATION OF EMPLOYMENT STATUS.

(a) IN GENERAL.—Subchapter B of chapter 76 (relating to proceedings by taxpayers and third parties) is amended by redesignating section 7436 as section 7437 and by inserting after section 7435 the following new section:

"SEC. 7436. PROCEEDINGS FOR DETERMINATION OF EMPLOYMENT STATUS.

"(a) CREATION OF REMEDY.—If, in connection with an audit of any person, there is an actual controversy involving a determination by the Secretary as part of an examination that—

"(1) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or

"(2) such person is not entitled to the treatment under subsection (a) of section 530 of the Revenue Act of 1978 with respect to such an individual,

upon the filing of an appropriate pleading, the Tax Court may determine whether such a determination by the Secretary is correct. Any such redetermination by the Tax Court shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

"(b) LIMITATIONS.—

"(1) PETITIONER.—A pleading may be filed under this section only by the person for whom the services are performed.

"(2) TIME FOR FILING ACTION.—If the Secretary sends by certified or registered mail notice to the petitioner of a determination by the Secretary described in subsection (a), no proceeding may be initiated under this section with respect to such determination unless the pleading is filed before the 91st day after the date of such mailing.

"(3) NO ADVERSE INFERENCE FROM TREATMENT WHILE ACTION IS PENDING.—If, during the pendency of any proceeding

brought under this section, the petitioner changes his treatment for employment tax purposes of any individual whose employment status as an employee is involved in such proceeding (or of any individual holding a substantially similar position) to treatment as an employee, such change shall not be taken into account in the Tax Court's determination under this section.

"(c) SMALL CASE PROCEDURES.—

"(1) IN GENERAL.—At the option of the petitioner, concurred in by the Tax Court or a division thereof before the hearing of the case, proceedings under this section may (notwithstanding the provisions of section 7453) be conducted subject to the rules of evidence, practice, and procedure applicable under section 7463 if the amount of employment taxes placed in dispute is $10,000 or less for each calendar quarter involved.

"(2) FINALITY OF DECISIONS.—A decision entered in any proceeding conducted under this subsection shall not be reviewed in any other court and shall not be treated as a precedent for any other case not involving the same petitioner and the same determinations.

"(3) CERTAIN RULES TO APPLY.—Rules similar to the rules of the last sentence of subsection (a), and subsections (c), (d), and (e), of section 7463 shall apply to proceedings conducted under this subsection.

"(d) SPECIAL RULES.—

"(1) RESTRICTIONS ON ASSESSMENT AND COLLECTION PENDING ACTION, ETC.—The principles of subsections (a), (b), (c), (d), and (f) of section 6213, section 6214(a), section 6215, section 6503(a), section 6512, and section 7481 shall apply to proceedings brought under this section in the same manner as if the Secretary's determination described in subsection (a) were a notice of deficiency.

"(2) AWARDING OF COSTS AND CERTAIN FEES.—Section 7430 shall apply to proceedings brought under this section.

"(e) EMPLOYMENT TAX.—The term 'employment tax' means any tax imposed by subtitle C.".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 6511 is amended by adding at the end the following new paragraph:

"(7) SPECIAL PERIOD OF LIMITATION WITH RESPECT TO SELF-EMPLOYMENT TAX IN CERTAIN CASES.—If—

"(A) the claim for credit or refund relates to an overpayment of the tax imposed by chapter 2 (relating to the tax on self-employment income) attributable to Tax Court determination in a proceeding under section 7436, and

"(B) the allowance of a credit or refund of such overpayment is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises),

such credit or refund may be allowed or made if claim therefor is filed on or before the last day of the second year after the calendar year in which such determination becomes final.".

(2) Subsection (a) of section 7421 is amended by striking "and 7429(b)" and inserting "7429(b), and 7436".

(3) Sections 7453 and 7481(b) are each amended by striking "section 7463" and inserting "section 7436(c) or 7463".

(4) The table of sections for subchapter B of chapter 76 is amended by striking the last item and inserting the following:

"Sec. 7436. Proceedings for determination of employment status.
"Sec. 7437. Cross references.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

Subtitle D—Other Provisions

SEC. 1461. EXTENSION OF DUE DATE OF FIRST QUARTER ESTIMATED TAX PAYMENT BY PRIVATE FOUNDATIONS.

(a) IN GENERAL.—Paragraph (3) of section 6655(g) is amended by adding at the end the following new sentence: "In the case of a private foundation, subsection (c)(2) shall be applied by substituting 'May 15' for 'April 15'.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply for purposes of determining underpayments of estimated tax for taxable years beginning after the date of the enactment of this Act.

SEC. 1462. CLARIFICATION OF AUTHORITY TO WITHHOLD PUERTO RICO INCOME TAXES FROM SALARIES OF FEDERAL EMPLOYEES.

(a) IN GENERAL.—Subsection (c) of section 5517 of title 5, United States Code, is amended by striking "or territory or possession" and inserting ", territory, possession, or commonwealth".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on January 1, 1998.

SEC. 1463. CERTAIN NOTICES DISREGARDED UNDER PROVISION INCREASING INTEREST RATE ON LARGE CORPORATE UNDERPAYMENTS.

(a) GENERAL RULE.—Subparagraph (B) of section 6621(c)(2) (defining applicable date) is amended by adding at the end the following new clause:

"(iii) EXCEPTION FOR LETTERS OR NOTICES INVOLVING SMALL AMOUNTS.—For purposes of this paragraph, any letter or notice shall be disregarded if the amount of the deficiency or proposed deficiency (or the assessment or proposed assessment) set forth in such letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply for purposes of determining interest for periods after December 31, 1997.

TITLE XV—PENSIONS AND EMPLOYEE BENEFITS

Subtitle A—Simplification

SEC. 1501. MATCHING CONTRIBUTIONS OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.

(a) IN GENERAL.—Section 402(g) (relating to limitation on exclusion for elective deferrals) is amended by adding at the end the following:

"(9) MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Except as provided in section 401(k)(3)(D)(ii), any matching contribution described in section 401(m)(4)(A) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) for purposes of this title.".

(b) CONFORMING AMENDMENT FOR SIMPLE RETIREMENT ACCOUNTS.—Section 408(p) (relating to simple retirement accounts) is amended by adding at the end the following:

"(8) MATCHING CONTRIBUTIONS ON BEHALF OF SELF-EMPLOYED INDIVIDUALS NOT TREATED AS ELECTIVE EMPLOYER CONTRIBUTIONS.—Any matching contribution described in paragraph (2)(A)(iii) which is made on behalf of a self-employed individual (as defined in section 401(c)) shall not be treated as an elective employer contribution to a simple retirement account for purposes of this title.".

(c) EFFECTIVE DATES.—

(1) ELECTIVE DEFERRALS.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1997.

(2) SIMPLE RETIREMENT ACCOUNTS.—The amendment made by subsection (b) shall apply to years beginning after December 31, 1996.

SEC. 1502. MODIFICATION OF PROHIBITION OF ASSIGNMENT OR ALIENATION.

(a) AMENDMENT TO ERISA.—Section 206(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1056(d)) is amended by adding at the end the following:

"(4) Paragraph (1) shall not apply to any offset of a participant's benefits provided under an employee pension benefit plan against an amount that the participant is ordered or required to pay to the plan if—

"(A) the order or requirement to pay arises—

"(i) under a judgment of conviction for a crime involving such plan,

"(ii) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of this subtitle, or

"(iii) pursuant to a settlement agreement between the Secretary and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of this subtitle by a fiduciary or any other person,

"(B) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

"(C) in a case in which the survivor annuity requirements of section 205 apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made—

"(i) either—

"(I) such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of circumstances described in section 205(c)(2)(B)), or

"(II) an election to waive the right of the spouse to a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 205(c),

"(ii) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of this subtitle, or

"(iii) in such judgment, order, decree, or settlement, such spouse retains the right to receive the survivor annuity under a qualified joint and survivor annuity provided pursuant to section 205(a)(1) and under a qualified preretirement survivor annuity provided pursuant to section 205(a)(2), determined in accordance with paragraph (5).

A plan shall not be treated as failing to meet the requirements of section 205 solely by reason of an offset under this paragraph.

"(5)(A) The survivor annuity described in paragraph (4)(C)(iii) shall be determined as if—

"(i) the participant terminated employment on the date of the offset,

"(ii) there was no offset,

"(iii) the plan permitted commencement of benefits only on or after normal retirement age,

"(iv) the plan provided only the minimum-required qualified joint and survivor annuity, and

"(v) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

"(B) For purposes of this paragraph, the term 'minimum-required qualified joint and survivor annuity' means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 3(23))

and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.".

(b) AMENDMENT TO 1986 CODE.—Section 401(a)(13) (relating to assignment and alienation) is amended by adding at the end the following:

"(C) SPECIAL RULE FOR CERTAIN JUDGMENTS AND SETTLEMENTS.—Subparagraph (A) shall not apply to any offset of a participant's benefits provided under a plan against an amount that the participant is ordered or required to pay to the plan if—

"(i) the order or requirement to pay arises—

"(I) under a judgment of conviction for a crime involving such plan,

"(II) under a civil judgment (including a consent order or decree) entered by a court in an action brought in connection with a violation (or alleged violation) of part 4 of subtitle B of title I of the Employee Retirement Income Security Act of 1974, or

"(III) pursuant to a settlement agreement between the Secretary of Labor and the participant, or a settlement agreement between the Pension Benefit Guaranty Corporation and the participant, in connection with a violation (or alleged violation) of part 4 of such subtitle by a fiduciary or any other person,

"(ii) the judgment, order, decree, or settlement agreement expressly provides for the offset of all or part of the amount ordered or required to be paid to the plan against the participant's benefits provided under the plan, and

"(iii) in a case in which the survivor annuity requirements of section 401(a)(11) apply with respect to distributions from the plan to the participant, if the participant has a spouse at the time at which the offset is to be made—

"(I) either such spouse has consented in writing to such offset and such consent is witnessed by a notary public or representative of the plan (or it is established to the satisfaction of a plan representative that such consent may not be obtained by reason of circumstances described in section 417(a)(2)(B)), or an election to waive the right of the spouse to either a qualified joint and survivor annuity or a qualified preretirement survivor annuity is in effect in accordance with the requirements of section 417(a),

"(II) such spouse is ordered or required in such judgment, order, decree, or settlement to pay an amount to the plan in connection with a violation of part 4 of such subtitle, or

"(III) in such judgment, order, decree, or settlement, such spouse retains the right to receive the

survivor annuity under a qualified joint and survivor annuity provided pursuant to section 401(a)(11)(A)(i) and under a qualified preretirement survivor annuity provided pursuant to section 401(a)(11)(A)(ii), determined in accordance with subparagraph (D).

A plan shall not be treated as failing to meet the requirements of this subsection, subsection (k), section 403(b), or section 409(d) solely by reason of an offset described in this subparagraph.

"(D) SURVIVOR ANNUITY.—

"(i) IN GENERAL.—The survivor annuity described in subparagraph (C)(iii)(III) shall be determined as if—

"(I) the participant terminated employment on the date of the offset,

"(II) there was no offset,

"(III) the plan permitted commencement of benefits only on or after normal retirement age,

"(IV) the plan provided only the minimum-required qualified joint and survivor annuity, and

"(V) the amount of the qualified preretirement survivor annuity under the plan is equal to the amount of the survivor annuity payable under the minimum-required qualified joint and survivor annuity.

"(ii) DEFINITION.—For purposes of this subparagraph, the term 'minimum-required qualified joint and survivor annuity' means the qualified joint and survivor annuity which is the actuarial equivalent of the participant's accrued benefit (within the meaning of section 411(a)(7)) and under which the survivor annuity is 50 percent of the amount of the annuity which is payable during the joint lives of the participant and the spouse.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to judgments, orders, and decrees issued, and settlement agreements entered into, on or after the date of the enactment of this Act.

SEC. 1503. ELIMINATION OF PAPERWORK BURDENS ON PLANS.

(a) ELIMINATION OF UNNECESSARY FILING REQUIREMENTS.—Section 101(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021(b)) is amended by striking paragraphs (1), (2), and (3) and by redesignating paragraphs (4) and (5) as paragraphs (1) and (2), respectively.

(b) ELIMINATION OF PLAN DESCRIPTION.—

(1) IN GENERAL.—Section 102(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1022(a)) is amended—

(A) by striking paragraph (2), and

(B) by striking "(a)(1)" and inserting "(a)".

(2) CONFORMING AMENDMENTS.—

(A) Section 102(b) of such Act (29 U.S.C. 1022(b)) is amended by striking "The plan description and summary

plan description shall contain" and inserting "The summary plan description shall contain".

(B) The heading for section 102 of such Act is amended by striking "PLAN DESCRIPTION AND".

(c) FURNISHING OF REPORTS.—

(1) IN GENERAL.—Section 104(a)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1024(a)(1)) is amended to read as follows:

"SEC. 104. (a)(1) The administrator of any employee benefit plan subject to this part shall file with the Secretary the annual report for a plan year within 210 days after the close of such year (or within such time as may be required by regulations promulgated by the Secretary in order to reduce duplicative filing). The Secretary shall make copies of such annual reports available for inspection in the public document room of the Department of Labor.".

(2) SECRETARY MAY REQUEST DOCUMENTS.—

(A) IN GENERAL.—Section 104(a) of such Act (29 U.S.C. 1024(a)) is amended by adding at the end the following:

"(6) The administrator of any employee benefit plan subject to this part shall furnish to the Secretary, upon request, any documents relating to the employee benefit plan, including but not limited to, the latest summary plan description (including any summaries of plan changes not contained in the summary plan description), and the bargaining agreement, trust agreement, contract, or other instrument under which the plan is established or operated.".

(B) PENALTY.—Section 502(c) of such Act (29 U.S.C. 1132(c)) is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following:

"(6) If, within 30 days of a request by the Secretary to a plan administrator for documents under section 104(a)(6), the plan administrator fails to furnish the material requested to the Secretary, the Secretary may assess a civil penalty against the plan administrator of up to $100 a day from the date of such failure (but in no event in excess of $1,000 per request). No penalty shall be imposed under this paragraph for any failure resulting from matters reasonably beyond the control of the plan administrator.".

(d) CONFORMING AMENDMENTS.—

(1) Section 104(b)(1) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1024(b)(1)) is amended by striking "section 102(a)(1)" each place it appears and inserting "section 102(a)".

(2) Section 104(b)(2) of such Act (29 U.S.C. 1024(b)(2)) is amended by striking "the plan description and" and inserting "the latest updated summary plan description and".

(3) Section 104(b)(4) of such Act (29 U.S.C. 1024(b)(4)) is amended by striking "plan description".

(4) Section 106(a) of such Act (29 U.S.C. 1026(a)) is amended by striking "descriptions,".

(5) Section 107 of such Act (29 U.S.C. 1027) is amended by striking "description or".

(6) Section 108(2)(B) of such Act (29 U.S.C. 1028(2)(B)) is amended by striking "plan descriptions, annual reports," and inserting "annual reports".

(7) Section 502(a)(6) of such Act (29 U.S.C. 1132(a)(6)) is amended by striking "or (5)" and inserting "(5), or (6)".

(e) TECHNICAL CORRECTION.—Section 1144(c) of the Social Security Act (42 U.S.C. 1320b–14(c)) is amended by redesignating paragraph (9) as paragraph (8).

SEC. 1504. MODIFICATION OF 403(b) EXCLUSION ALLOWANCE TO CONFORM TO 415 MODIFICATIONS.

(a) DEFINITION OF COMPENSATION.—

(1) IN GENERAL.—Section 403(b)(3) (defining includible compensation) is amended by adding at the end the following: "Such term includes—

"(A) any elective deferral (as defined in section 402(g)(3)), and

"(B) any amount which is contributed or deferred by the employer at the election of the employee and which is not includible in the gross income of the employee by reason of section 125 or 457.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 1997.

(b) REPEAL OF RULES IN SECTION 415(e).—The Secretary of the Treasury shall modify the regulations regarding the exclusion allowance under section 403(b)(2) of the Internal Revenue Code of 1986 to reflect the amendment made by section 1452(a) of the Small Business Job Protection Act of 1996. Such modification shall take effect for years beginning after December 31, 1999.

SEC. 1505. EXTENSION OF MORATORIUM ON APPLICATION OF CERTAIN NONDISCRIMINATION RULES TO STATE AND LOCAL GOVERNMENTS.

(a) GENERAL NONDISCRIMINATION AND PARTICIPATION RULES.—

(1) NONDISCRIMINATION REQUIREMENTS.—Section 401(a)(5) (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by adding at the end the following:

"(G) STATE AND LOCAL GOVERNMENTAL PLANS.—Paragraphs (3) and (4) shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).".

(2) ADDITIONAL PARTICIPATION REQUIREMENTS.—Section 401(a)(26)(H) (relating to additional participation requirements) is amended to read as follows:

"(H) EXCEPTION FOR STATE AND LOCAL GOVERNMENTAL PLANS.—This paragraph shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).".

(3) MINIMUM PARTICIPATION STANDARDS.—Section 410(c)(2) (relating to application of participation standards to certain plans) is amended to read as follows:

"(2) A plan described in paragraph (1) shall be treated as meeting the requirements of this section for purposes of section 401(a), except that in the case of a plan described in subparagraph (B), (C), or (D) of paragraph (1), this paragraph shall apply only if such plan meets the requirements of section 401(a)(3) (as in effect on September 1, 1974).".

(b) PARTICIPATION AND DISCRIMINATION STANDARDS FOR QUALIFIED CASH OR DEFERRED ARRANGEMENTS.—Section 401(k)(3) (relating to application of participation and discrimination standards) is amended by adding at the end the following:

"(G) A governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as meeting the requirements of this paragraph.".

(c) NONDISCRIMINATION RULES FOR SECTION 403(b) PLANS.—Section 403(b)(12) (relating to nondiscrimination requirements) is amended by adding at the end the following:

"(C) STATE AND LOCAL GOVERNMENTAL PLANS.—For purposes of paragraph (1)(D), the requirements of subparagraph (A)(i) (other than those relating to section 401(a)(17)) shall not apply to a governmental plan (within the meaning of section 414(d)) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof).".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section apply to taxable years beginning on or after the date of enactment of this Act.

(2) TREATMENT FOR YEARS BEGINNING BEFORE DATE OF ENACTMENT.—A governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986) maintained by a State or local government or political subdivision thereof (or agency or instrumentality thereof) shall be treated as satisfying the requirements of sections 401(a)(3), 401(a)(4), 401(a)(26), 401(k), 401(m), 403 (b)(1)(D) and (b)(12), and 410 of such Code for all taxable years beginning before the date of enactment of this Act.

SEC. 1506. CLARIFICATION OF CERTAIN RULES RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS OF S CORPORATIONS.

(a) CERTAIN CASH DISTRIBUTIONS PERMITTED.—

(1) Paragraph (2) of section 409(h) is amended by adding at the end the following new subparagraph:

"(B) EXCEPTION FOR CERTAIN PLANS RESTRICTED FROM DISTRIBUTING SECURITIES.—

"(i) IN GENERAL.—A plan to which this subparagraph applies shall not be treated as failing to meet the requirements of this subsection or section 401(a) merely because it does not permit a participant to exercise the right described in paragraph (1)(A) if such plan provides that the participant entitled to a distribution has a right to receive the distribution in cash, except that such plan may distribute employer securities subject to a requirement that such securities may be resold to the employer under terms which meet the requirements of paragraph (1)(B).

"(ii) APPLICABLE PLANS.—This subparagraph shall apply to a plan which otherwise meets the requirements of this subsection or section 4975(e)(7) and which is established and maintained by—

"(I) an employer whose charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a trust described in section 401(a), or

"(II) an S corporation."

(2) Paragraph (2) of section 409(h), as in effect before the amendment made by paragraph (1), is amended—

(A) by striking "A plan which" in the first sentence and inserting the following:

"(A) IN GENERAL.—A plan which", and

(B) by striking the last sentence.

(b) CERTAIN SHAREHOLDER-EMPLOYEES NOT TREATED AS OWNER-EMPLOYEES.—

(1) AMENDMENT TO 1986 CODE.—

(A) IN GENERAL.—Section 4975(f) is amended by adding at the end the following new paragraph:

"(6) EXEMPTIONS NOT TO APPLY TO CERTAIN TRANSACTIONS.—

"(A) IN GENERAL.—In the case of a trust described in section 401(a) which is part of a plan providing contributions or benefits for employees some or all of whom are owner-employees (as defined in section 401(c)(3)), the exemptions provided by subsection (d) (other than paragraphs (9) and (12)) shall not apply to a transaction in which the plan directly or indirectly—

"(i) lends any part of the corpus or income of the plan to,

"(ii) pays any compensation for personal services rendered to the plan to, or

"(iii) acquires for the plan any property from, or sells any property to,

any such owner-employee, a member of the family (as defined in section 267(c)(4)) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

"(B) SPECIAL RULES FOR SHAREHOLDER-EMPLOYEES, ETC.—

"(i) IN GENERAL.—For purposes of subparagraph (A), the following shall be treated as owner-employees:

"(I) A shareholder-employee.

"(II) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37)).

"(III) An employer or association of employees which establishes such an individual retirement plan under section 408(c).

"(ii) EXCEPTION FOR CERTAIN TRANSACTIONS INVOLVING SHAREHOLDER-EMPLOYEES.—Subparagraph (A)(iii) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in subsection (e)(7)) by a

shareholder-employee, a member of the family (as defined in section 267(c)(4)) of such shareholder-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in subparagraph (A).

"(C) SHAREHOLDER-EMPLOYEE.—For purposes of subparagraph (B), the term 'shareholder-employee' means an employee or officer of an S corporation who owns (or is considered as owning within the meaning of section 318(a)(1)) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation."

(B) CONFORMING AMENDMENTS.—Section 4975(d) is amended—

(i) by striking "The prohibitions" and inserting "Except as provided in subsection (f)(6), the prohibitions", and

(ii) by striking the last two sentences thereof.

(2) AMENDMENT TO ERISA.—Section 408(d) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(d)) is amended to read as follows:

"(d)(1) Section 407(b) and subsections (b), (c), and (e) of this section shall not apply to a transaction in which a plan directly or indirectly—

"(A) lends any part of the corpus or income of the plan to,

"(B) pays any compensation for personal services rendered to the plan to, or

"(C) acquires for the plan any property from, or sells any property to,

any person who is with respect to the plan an owner-employee (as defined in section 401(c)(3) of the Internal Revenue Code of 1986), a member of the family (as defined in section 267(c)(4) of such Code) of any such owner-employee, or any corporation in which any such owner-employee owns, directly or indirectly, 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

"(2)(A) For purposes of paragraph (1), the following shall be treated as owner-employees:

"(i) A shareholder-employee.

"(ii) A participant or beneficiary of an individual retirement plan (as defined in section 7701(a)(37) of the Internal Revenue Code of 1986).

"(iii) An employer or association of employees which establishes such an individual retirement plan under section 408(c) of such Code.

"(B) Paragraph (1)(C) shall not apply to a transaction which consists of a sale of employer securities to an employee stock ownership plan (as defined in section 407(d)(6)) by a shareholder-employee, a member of the family (as defined in section 267(c)(4) of such Code) of any such owner-employee, or a corporation in which such a shareholder-employee owns stock representing a 50 percent or greater interest described in paragraph (1).

"(3) For purposes of paragraph (2), the term 'shareholder-employee' means an employee or officer of an S corporation (as defined in section 1361(a)(1) of such Code) who owns (or is considered as owning within the meaning of section 318(a)(1) of such Code) more than 5 percent of the outstanding stock of the corporation on any day during the taxable year of such corporation."

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

SEC. 1507. MODIFICATION OF 10-PERCENT TAX FOR NONDEDUCTIBLE CONTRIBUTIONS.

(a) IN GENERAL.—Section 4972(c)(6)(B) (relating to exceptions) is amended to read as follows:

"(B) so much of the contributions to 1 or more defined contribution plans which are not deductible when contributed solely because of section 404(a)(7) as does not exceed the greater of—

"(i) the amount of contributions not in excess of 6 percent of compensation (within the meaning of section 404(a)) paid or accrued (during the taxable year for which the contributions were made) to beneficiaries under the plans, or

"(ii) the sum of—

"(I) the amount of contributions described in section 401(m)(4)(A), plus

"(II) the amount of contributions described in section 402(g)(3)(A).".

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

SEC. 1508. MODIFICATION OF FUNDING REQUIREMENTS FOR CERTAIN PLANS.

(a) FUNDING RULES FOR CERTAIN PLANS.—Section 769 of the Retirement Protection Act of 1994 is amended by adding at the end the following new subsection:

"(c) TRANSITION RULES FOR CERTAIN PLANS.—

"(1) IN GENERAL.—In the case of a plan that—

"(A) was not required to pay a variable rate premium for the plan year beginning in 1996;

"(B) has not, in any plan year beginning after 1995 and before 2009, merged with another plan (other than a plan sponsored by an employer that was in 1996 within the controlled group of the plan sponsor); and

"(C) is sponsored by a company that is engaged primarily in the interurban or interstate passenger bus service,

the transition rules described in paragraph (2) shall apply for any plan year beginning after 1996 and before 2010.

"(2) TRANSITION RULES.—The transition rules described in this paragraph are as follows:

"(A) For purposes of section 412(l)(9)(A) of the Internal Revenue Code of 1986 and section 302(d)(9)(A) of the Employee Retirement Income Security Act of 1974—

"(i) the funded current liability percentage for any plan year beginning after 1996 and before 2005 shall be treated as not less than 90 percent if for such plan

year the funded current liability percentage is at least 85 percent, and

"(ii) the funded current liability percentage for any plan year beginning after 2004 and before 2010 shall be treated as not less than 90 percent if for such plan year the funded current liability percentage satisfies the minimum percentage determined according to the following table:

"In the case of a plan year beginning in:	*The minimum percentage is:*
2005	*86*
2006	*87*
2007	*88*
2008	*89*
2009 and thereafter	*90.*

"(B) Sections 412(c)(7)(E)(i)(I) of such Code and 302(c)(7)(E)(i)(I) of such Act shall be applied—

"(i) by substituting '85 percent' for '90 percent' for plan years beginning after 1996 and before 2005, and

"(ii) by substituting the minimum percentage specified in the table contained in subparagraph (A)(ii) for '90 percent' for plan years beginning after 2004 and before 2010.

"(C) In the event the funded current liability percentage of a plan is less than 85 percent for any plan year beginning after 1996 and before 2005, the transition rules under subparagraphs (A) and (B) shall continue to apply to the plan if contributions for such a plan year are made to the plan in an amount equal to the lesser of—

"(i) the amount necessary to result in a funded current liability percentage of 85 percent, or

"(ii) the greater of—

"(I) 2 percent of the plan's current liability as of the beginning of such plan year, or

"(II) the amount necessary to result in a funded current liability percentage of 80 percent as of the end of such plan year.

For the plan year beginning in 2005 and for each of the 3 succeeding plan years, the transition rules under subparagraphs (A) and (B) shall continue to apply to the plan for such plan year only if contributions to the plan for such plan year equal at least the expected increase in current liability due to benefits accruing during such plan year.".

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

SEC. 1509. CLARIFICATION OF DISQUALIFICATION RULES RELATING TO ACCEPTANCE OF ROLLOVER CONTRIBUTIONS.

The Secretary of the Treasury or his delegate shall clarify that, under the Internal Revenue Service regulations protecting pension plans from disqualification by reason of the receipt of invalid rollover contributions under section 402(c) of the Internal Revenue Code of 1986, in order for the administrator of the plan receiving any such contribution to reasonably conclude that the contribution is a valid rollover contribution it is not necessary for the distributing *plan to have a determination letter with respect to its status as a qualified plan under section 401 of such Code.*

SEC. 1510. NEW TECHNOLOGIES IN RETIREMENT PLANS.

(a) IN GENERAL.—Not later than December 31, 1998, the Secretary of the Treasury and the Secretary of Labor shall each issue guidance which is designed to—

(1) interpret the notice, election, consent, disclosure, and time requirements (and related recordkeeping requirements) under the Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 relating to retirement plans as applied to the use of new technologies by plan sponsors and administrators while maintaining the protection of the rights of participants and beneficiaries, and

(2) clarify the extent to which writing requirements under the Internal Revenue Code of 1986 relating to retirement plans shall be interpreted to permit paperless transactions.

(b) APPLICABILITY OF FINAL REGULATIONS.—Final regulations applicable to the guidance regarding new technologies described in subsection (a) shall not be effective until the first plan year beginning at least 6 months after the issuance of such final regulations.

Subtitle B—Other Provisions Relating to Pensions and Employee Benefits

SEC. 1521. INCREASE IN CURRENT LIABILITY FUNDING LIMIT.

(a) AMENDMENT TO 1986 CODE.—Section 412(c)(7) (relating to full-funding limitation) is amended—

(A) by striking "150 percent" in subparagraph (A)(i)(I) and inserting "the applicable percentage", and

(B) by adding at the end the following:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	***The applicable percentage is—***
1999 or 2000	*155*
2001 or 2002	*160*
2003 or 2004	*165*
2005 and succeeding years	*170.".*

(b) AMENDMENT TO ERISA.—Section 302(c)(7) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)) is amended—

(A) by striking "150 percent" in subparagraph (A)(i)(I) and inserting "the applicable percentage", and

(B) by adding at the end the following:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	***The applicable percentage is—***
1999 or 2000	*155*
2001 or 2002	*160*
2003 or 2004	*165*
2005 and succeeding years	*170.".*

(c) SPECIAL AMORTIZATION RULE.—

(1) CODE AMENDMENT.—Section 412(b)(2) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by inserting after subparagraph (D) the following:

"(E) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 20 years the contributions which would be required to be made under the plan but for the provisions of subsection (c)(7)(A)(i)(I).".

(2) ERISA AMENDMENT.—Section 302(b)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(b)(2)) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by inserting after subparagraph (D) the following:

"(E) the amount necessary to amortize in equal annual installments (until fully amortized) over a period of 20 years the contributions which would be required to be made under the plan but for the provisions of subsection (c)(7)(A)(i)(I).".

(3) CONFORMING AMENDMENTS.—

(A) Section 412(c)(7)(D) is amended by adding "and" at the end of clause (i), by striking ", and" at the end of clause (ii) and inserting a period, and by striking clause (iii).

(B) Section 302(c)(7)(D) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)(D)) is amended by adding "and" at the end of clause (i), by striking ", and" at the end of clause (ii) and inserting a period, and by striking clause (iii).

(d) EFFECTIVE DATES.—

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

(2) SPECIAL RULE FOR UNAMORTIZED BALANCES UNDER EXISTING LAW.—The unamortized balance (as of the close of the plan year preceding the plan's first year beginning in 1999) of any amortization base established under section 412(c)(7)(D)(iii) of such Code and section 302(c)(7)(D)(iii) of such Act (as repealed by subsection (c)(3)) for any plan year beginning before 1999 shall be amortized in equal annual installments (until fully amortized) over a period of years equal to the excess of—

(A) 20 years, over

(B) the number of years since the amortization base was established.

SEC. 1522. SPECIAL RULES FOR CHURCH PLANS.

(a) IN GENERAL.—Section 414(e)(5) (relating to special rules for chaplains and self-employed ministers) is amended—

(1) by striking "not eligible to participate" in subparagraph (C) and inserting "not otherwise participating", and

(2) by adding at the end the following new subparagraph:

"(E) EXCLUSION.—In the case of a contribution to a church plan made on behalf of a minister described in subparagraph (A)(i)(II), such contribution shall not be included in the gross income of the minister to the extent that

such contribution would not be so included if the minister was an employee of a church.".

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

SEC. 1523. REPEAL OF APPLICATION OF UNRELATED BUSINESS INCOME TAX TO ESOPS.

(a) IN GENERAL.—Section 512(e) is amended by adding at the end the following new paragraph:

"(3) EXCEPTION FOR ESOPS.—This subsection shall not apply to employer securities (within the meaning of section 409(l)) held by an employee stock ownership plan described in section 4975(e)(7)."

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

SEC. 1524. DIVERSIFICATION OF SECTION 401(k) PLAN INVESTMENTS.

(a) LIMITATIONS ON INVESTMENT IN EMPLOYER SECURITIES AND EMPLOYER REAL PROPERTY BY CASH OR DEFERRED ARRANGEMENTS.—Section 407(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1107(b)) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2)(A) If this paragraph applies to an eligible individual account plan, the portion of such plan which consists of applicable elective deferrals (and earnings allocable thereto) shall be treated as a separate plan—

"(i) which is not an eligible individual account plan, and

"(ii) to which the requirements of this section apply.

"(B)(i) This paragraph shall apply to any eligible individual account plan if any portion of the plan's applicable elective deferrals (or earnings allocable thereto) are required to be invested in qualifying employer securities or qualifying employer real property or both—

"(I) pursuant to the terms of the plan, or

"(II) at the direction of a person other than the participant on whose behalf such elective deferrals are made to the plan (or a beneficiary).

"(ii) This paragraph shall not apply to an individual account plan for a plan year if, on the last day of the preceding plan year, the fair market value of the assets of all individual account plans maintained by the employer equals not more than 10 percent of the fair market value of the assets of all pension plans (other than multiemployer plans) maintained by the employer.

"(iii) This paragraph shall not apply to an individual account plan that is an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code of 1986.

"(iv) This paragraph shall not apply to an individual account plan if, pursuant to the terms of the plan, the portion of any employee's applicable elective deferrals which is required to be invested in qualifying employer securities and qualifying employer real property for any year may not exceed 1 percent of the employee's compensation which is taken into account under the

plan in determining the maximum amount of the employee's applicable elective deferrals for such year.

"(C) For purposes of this paragraph, the term 'applicable elective deferral' means any elective deferral (as defined in section 402(g)(3)(A) of the Internal Revenue Code of 1986) which is made pursuant to a qualified cash or deferred arrangement as defined in section 401(k) of the Internal Revenue Code of 1986."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to elective deferrals for plan years beginning after December 31, 1998.

SEC. 1525. SECTION 401(K) PLANS FOR CERTAIN IRRIGATION AND DRAINAGE ENTITIES.

(a) IN GENERAL.—Subparagraph (B) of section 401(k)(7) (relating to rural cooperative plan) is amended—

(1) by striking "and" at the end of clause (iii), by redesignating clause (iv) as clause (v), and by inserting after clause (iii) the following new clause:

"(iv) any organization which—

"(I) is a mutual irrigation or ditch company described in section 501(c)(12) (without regard to the 85 percent requirement thereof), or

"(II) is a district organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation, or drainage, and", and

(2) in clause (v), as so redesignated, by striking "or (iii)" and inserting ", (iii), or (iv)".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to years beginning after December 31, 1997.

SEC. 1526. PORTABILITY OF PERMISSIVE SERVICE CREDIT UNDER GOVERNMENTAL PENSION PLANS.

(a) IN GENERAL.—Section 415 (relating to limitations on benefits and contributions under qualified plans) is amended by adding at the end the following new subsection:

"(n) SPECIAL RULES RELATING TO PURCHASE OF PERMISSIVE SERVICE CREDIT.—

"(1) IN GENERAL.—If an employee makes 1 or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of this section shall be treated as met only if—

"(A) the requirements of subsection (b) are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of subsection (b), or

"(B) the requirements of subsection (c) are met, determined by treating all such contributions as annual additions for purposes of subsection (c).

"(2) APPLICATION OF LIMIT.—For purposes of—

"(A) applying paragraph (1)(A), the plan shall not fail to meet the reduced limit under subsection (b)(2)(C) solely by reason of this subsection, and

"(B) applying paragraph (1)(B), the plan shall not fail to meet the percentage limitation under subsection (c)(1)(B) solely by reason of this subsection.

"(3) PERMISSIVE SERVICE CREDIT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'permissive service credit' means service credit—

"(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

"(ii) which such participant has not received under such governmental plan, and

"(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

"(B) LIMITATION ON NONQUALIFIED SERVICE CREDIT.—A plan shall fail to meet the requirements of this section if—

"(i) more than 5 years of permissive service credit attributable to nonqualified service are taken into account for purposes of this subsection, or

"(ii) any permissive service credit attributable to nonqualified service is taken into account under this subsection before the employee has at least 5 years of participation under the plan.

"(C) NONQUALIFIED SERVICE.—For purposes of subparagraph (B), the term 'nonqualified service' means service for which permissive service credit is allowed other than—

"(i) service (including parental, medical, sabbatical, and similar leave) as an employee of the Government of the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing (other than military service or service for credit which was obtained as a result of a repayment described in subsection (k)(3)),

"(ii) service (including parental, medical, sabbatical, and similar leave) as an employee (other than as an employee described in clause (i)) of an educational organization described in section 170(b)(1)(A)(ii) which is a public, private, or sectarian school which provides elementary or secondary education (through grade 12), as determined under State law,

"(iii) service as an employee of an association of employees who are described in clause (i), or

"(iv) military service (other than qualified military service under section 414(u)) recognized by such governmental plan.

In the case of service described in clauses (i), (ii), or (iii), such service will be nonqualified service if recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan."

(b) SPECIAL RULE FOR REPAYMENT OF CASHOUTS.—Section 415(k) (relating to special rules) is amended by adding at the end the following new paragraph:

"(3) REPAYMENTS OF CASHOUTS UNDER GOVERNMENTAL PLANS.—In the case of any repayment of contributions (including interest thereon) to the governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan or under another governmental plan maintained by a State or local government employer within the same State, any such repayment shall not be taken into account for purposes of this section."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to permissive service credit contributions made in years beginning after December 31, 1997.

(2) TRANSITION RULE.—

(A) IN GENERAL.—In the case of an eligible participant in a governmental plan (within the meaning of section 414(d) of the Internal Revenue Code of 1986), the limitations of section 415(c)(1) of such Code shall not be applied to reduce the amount of permissive service credit which may be purchased to an amount less than the amount which was allowed to be purchased under the terms of the plan as in effect on the date of the enactment of this Act.

(B) ELIGIBLE PARTICIPANT.—For purposes of subparagraph (A), an eligible participant is an individual who first became a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of the enactment of this Act) of the governing body with authority to amend the plan ends.

SEC. 1527. REMOVAL OF DOLLAR LIMITATION ON BENEFIT PAYMENTS FROM A DEFINED BENEFIT PLAN MAINTAINED FOR CERTAIN POLICE AND FIRE EMPLOYEES.

(a) IN GENERAL.—Subparagraph (G) of section 415(b)(2) is amended by striking "participant—" and all that follows and inserting "participant, subparagraph (C) of this paragraph shall not apply.".

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

SEC. 1528. SURVIVOR BENEFITS FOR PUBLIC SAFETY OFFICERS KILLED IN THE LINE OF DUTY.

(a) IN GENERAL.—Section 101 (relating to certain death benefits) is amended by adding at the end the following new subsection:

"(h) SURVIVOR BENEFITS ATTRIBUTABLE TO SERVICE BY A PUBLIC SAFETY OFFICER WHO IS KILLED IN THE LINE OF DUTY.—

"(1) IN GENERAL.—Gross income shall not include any amount paid as a survivor annuity on account of the death of a public safety officer (as such term is defined in section 1204 of the Omnibus Crime Control and Safe Streets Act of 1968) killed in the line of duty—

"(A) if such annuity is provided, under a governmental plan which meets the requirements of section 401(a), to the

spouse (or a former spouse) of the public safety officer or to a child of such officer; and

"(B) to the extent such annuity is attributable to such officer's service as a public safety officer.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply with respect to the death of any public safety officer if, as determined in accordance with the provisions of the Omnibus Crime Control and Safe Streets Act of 1968—

"(A) the death was caused by the intentional misconduct of the officer or by such officer's intention to bring about such officer's death;

"(B) the officer was voluntarily intoxicated (as defined in section 1204 of such Act) at the time of death;

"(C) the officer was performing such officer's duties in a grossly negligent manner at the time of death; or

"(D) the payment is to an individual whose actions were a substantial contributing factor to the death of the officer.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after such date.

SEC. 1529. TREATMENT OF CERTAIN DISABILITY BENEFITS RECEIVED BY FORMER POLICE OFFICERS OR FIREFIGHTERS.

(a) GENERAL RULE.—For purposes of determining whether any amount to which this section applies is excludable from gross income under section 104(a)(1) of the Internal Revenue Code of 1986, the following conditions shall be treated as personal injuries or sickness in the course of employment:

(1) Heart disease.

(2) Hypertension.

(b) AMOUNTS TO WHICH SECTION APPLIES.—This section shall apply to any amount—

(1) which is payable—

(A) to an individual (or to the survivors of an individual) who was a full-time employee of any police department or fire department which is organized and operated by a State, by any political subdivision thereof, or by any agency or instrumentality of a State or political subdivision thereof, and

(B) under a State law (as amended on May 19, 1992) which irrebuttably presumed that heart disease and hypertension are work-related illnesses but only for employees separating from service before July 1, 1992; and

(2) which was received in calendar year 1989, 1990, or 1991.

(c) WAIVER OF STATUTE OF LIMITATIONS.—If, on the date of the enactment of this Act (or at any time within the 1-year period beginning on such date of enactment), credit or refund of any overpayment of tax resulting from the provisions of this section is barred by any law or rule of law (including res judicata), then credit or refund of such overpayment shall, nevertheless, be allowed or made if claim therefore is filed before the date 1 year after such date of enactment.

SEC. 1530. GRATUITOUS TRANSFERS FOR THE BENEFIT OF EMPLOYEES.

(a) IN GENERAL.—Subparagraph (C) of section 664(d)(1) and subparagraph (C) of section 664(d)(2) are each amended by striking the period at the end thereof and inserting "or, to the extent the remainder interest is in qualified employer securities (as defined in subsection (g)(4)), all or part of such securities are to be transferred to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by subsection (g)).".

(b) QUALIFIED GRATUITOUS TRANSFER DEFINED.—Section 664 is amended by adding at the end the following new subsection:

"(g) QUALIFIED GRATUITOUS TRANSFER OF QUALIFIED EMPLOYER SECURITIES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified gratuitous transfer' means a transfer of qualified employer securities to an employee stock ownership plan (as defined in section 4975(e)(7)) but only to the extent that—

"(A) the securities transferred previously passed from a decedent dying before January 1, 1999, to a trust described in paragraph (1) or (2) of subsection (d),

"(B) no deduction under section 404 is allowable with respect to such transfer,

"(C) such plan contains the provisions required by paragraph (3),

"(D) such plan treats such securities as being attributable to employer contributions but without regard to the limitations otherwise applicable to such contributions under section 404, and

"(E) the employer whose employees are covered by the plan described in this paragraph files with the Secretary a verified written statement consenting to the application of sections 4978 and 4979A with respect to such employer.

"(2) EXCEPTION.—The term 'qualified gratuitous transfer' shall not include a transfer of qualified employer securities to an employee stock ownership plan unless—

"(A) such plan was in existence on August 1, 1996,

"(B) at the time of the transfer, the decedent and members of the decedent's family (within the meaning of section 2032A(e)(2)) own (directly or through the application of section 318(a)) no more than 10 percent of the value of the stock of the corporation referred to in paragraph (4), and

"(C) immediately after the transfer, such plan owns (after the application of section 318(a)(4)) at least 60 percent of the value of the outstanding stock of the corporation.

"(3) PLAN REQUIREMENTS.—A plan contains the provisions required by this paragraph if such plan provides that—

"(A) the qualified employer securities so transferred are allocated to plan participants in a manner consistent with section 401(a)(4),

"(B) plan participants are entitled to direct the plan as to the manner in which such securities which are entitled to vote and are allocated to the account of such participant are to be voted,

"(C) an independent trustee votes the securities so transferred which are not allocated to plan participants,

"(D) each participant who is entitled to a distribution from the plan has the rights described in subparagraphs (A) and (B) of section 409(h)(1),

"(E) such securities are held in a suspense account under the plan to be allocated each year, up to the limitations under section 415(c), after first allocating all other annual additions for the limitation year, up to the limitations under sections 415 (c) and (e), and

"(F) on termination of the plan, all securities so transferred which are not allocated to plan participants as of such termination are to be transferred to, or for the use of, an organization described in section 170(c).

For purposes of the preceding sentence, the term 'independent trustee' means any trustee who is not a member of the family (within the meaning of section 2032A(e)(2)) of the decedent or a 5-percent shareholder. A plan shall not fail to be treated as meeting the requirements of section 401(a) by reason of meeting the requirements of this subsection.

"(4) QUALIFIED EMPLOYER SECURITIES.—For purposes of this section, the term 'qualified employer securities' means employer securities (as defined in section 409(l)) which are issued by a domestic corporation—

"(A) which has no outstanding stock which is readily tradable on an established securities market, and

"(B) which has only 1 class of stock.

"(5) TREATMENT OF SECURITIES ALLOCATED BY EMPLOYEE STOCK OWNERSHIP PLAN TO PERSONS RELATED TO DECEDENT OR 5-PERCENT SHAREHOLDERS.—

"(A) IN GENERAL.—If any portion of the assets of the plan attributable to securities acquired by the plan in a qualified gratuitous transfer are allocated to the account of—

"(i) any person who is related to the decedent (within the meaning of section 267(b)) or a member of the decedent's family (within the meaning of section 2032A(e)(2)), or

"(ii) any person who, at the time of such allocation or at any time during the 1-year period ending on the date of the acquisition of qualified employer securities by the plan, is a 5-percent shareholder of the employer maintaining the plan,

the plan shall be treated as having distributed (at the time of such allocation) to such person or shareholder the amount so allocated.

"(B) 5-PERCENT SHAREHOLDER.—For purposes of subparagraph (A), the term '5-percent shareholder' means any person who owns (directly or through the application of section 318(a)) more than 5 percent of the outstanding stock of the corporation which issued such qualified employer securities or of any corporation which is a member of the same controlled group of corporations (within the meaning of section 409(l)(4)) as such corporation. For purposes of the

preceding sentence, section 318(a) shall be applied without regard to the exception in paragraph (2)(B)(i) thereof.

"(C) CROSS REFERENCE.—

"For excise tax on allocations described in subparagraph (A), see section 4979A.

"(6) TAX ON FAILURE TO TRANSFER UNALLOCATED SECURITIES TO CHARITY ON TERMINATION OF PLAN.—If the requirements of paragraph (3)(F) are not met with respect to any securities, there is hereby imposed a tax on the employer maintaining the plan in an amount equal to the sum of—

"(A) the amount of the increase in the tax which would be imposed by chapter 11 if such securities were not transferred as described in paragraph (1), and

"(B) interest on such amount at the underpayment rate under section 6621 (and compounded daily) from the due date for filing the return of the tax imposed by chapter 11.".

(c) CONFORMING AMENDMENTS.—

(1) Section 401(a)(1) is amended by inserting "or by a charitable remainder trust pursuant to a qualified gratuitous transfer (as defined in section 664(g)(1))," after "stock bonus plans),".

(2) Section 404(a)(9) is amended by inserting after subparagraph (B) the following new subparagraph:

"(C) A qualified gratuitous transfer (as defined in section 664(g)(1)) shall have no effect on the amount or amounts otherwise deductible under paragraph (3) or (7) or under this paragraph.".

(3) Section 415(c)(6) is amended by adding at the end thereof the following new sentence:

"The amount of any qualified gratuitous transfer (as defined in section 664(g)(1)) allocated to a participant for any limitation year shall not exceed the limitations imposed by this section, but such amount shall not be taken into account in determining whether any other amount exceeds the limitations imposed by this section.".

(4) Section 415(e) is amended—

(A) by redesignating paragraph (6) as paragraph (7), and

(B) by inserting after paragraph (5) the following new paragraph:

"(6) SPECIAL RULE FOR QUALIFIED GRATUITOUS TRANSFERS.—Any qualified gratuitous transfer of qualified employer securities (as defined by section 664(g)) shall not be taken into account in calculating, and shall not be subject to, the limitations provided in this subsection.".

(5) Subparagraph (B) of section 664(d)(1) and subparagraph (B) of section 664(d)(2) are each amended by inserting "and other than qualified gratuitous transfers described in subparagraph (C)" after "subparagraph (A)".

(6) Paragraph (4) of section 674(b) is amended by inserting before the period "or to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined in section 664(g)(1))".

(7) Section 2055(a) is amended—

(i) by striking "or" at the end of paragraph (3),

(ii) by striking the period at the end of paragraph (4) and inserting "; or", and

(iii) by inserting after paragraph (4) the following new paragraph:

"(5) to an employee stock ownership plan if such transfer qualifies as a qualified gratuitous transfer of qualified employer securities within the meaning of section 664(g).".

(8) Paragraph (8) of section 2056(b) is amended to read as follows:

"(8) SPECIAL RULE FOR CHARITABLE REMAINDER TRUSTS.—

"(A) IN GENERAL.—If the surviving spouse of the decedent is the only beneficiary of a qualified charitable remainder trust who is not a charitable beneficiary nor an ESOP beneficiary, paragraph (1) shall not apply to any interest in such trust which passes or has passed from the decedent to such surviving spouse.

"(B) DEFINITIONS.—For purposes of subparagraph (A)—

"(i) CHARITABLE BENEFICIARY.—The term 'charitable beneficiary' means any beneficiary which is an organization described in section 170(c).

"(ii) ESOP BENEFICIARY.—The term 'ESOP beneficiary' means any beneficiary which is an employee stock ownership plan (as defined in section 4975(e)(7)) that holds a remainder interest in qualified employer securities (as defined in section 664(g)(4)) to be transferred to such plan in a qualified gratuitous transfer (as defined in section 664(g)(1)).

"(iii) QUALIFIED CHARITABLE REMAINDER TRUST.—The term 'qualified charitable remainder trust' means a charitable remainder annuity trust or a charitable remainder unitrust (described in section 664).".

(9) Section 4947(b) is amended by inserting after paragraph (3) the following new paragraph:

"(4) SECTION 507.—The provisions of section 507(a) shall not apply to a trust which is described in subsection (a)(2) by reason of a distribution of qualified employer securities (as defined in section 664(g)(4)) to an employee stock ownership plan (as defined in section 4975(e)(7)) in a qualified gratuitous transfer (as defined by section 664(g)).".

(10) The last sentence of section 4975(e)(7) is amended by inserting "and section 664(g)" after "section 409(n)"

(11) Subsection (a) of section 4978 is amended—

(A) by inserting "or acquired any qualified employer securities in a qualified gratuitous transfer to which section 664(g) applied" after "section 1042 applied", and

(B) by inserting before the comma at the end of paragraph (2) "60 percent of the total value of all employer securities as of such disposition in the case of any qualified employer securities acquired in a qualified gratuitous transfer to which section 664(g) applied)".

(12) Paragraph (2) of section 4978(b) is amended—

(A) by inserting "or acquired in the qualified gratuitous transfer to which section 664(g) applied" after "section 1042 applied", and

(B) by inserting "or to which section 664(g) applied" after "section 1042 applied" in subparagraph (A) thereof.

(13) Subsection (c) of section 4978 is amended by striking "written statement" and all that follows and inserting "written statement described in section 664(g)(1)(E) or in section 1042(b)(3) (as the case may be).".

(14) Paragraph (2) of section 4978(e) is amended by striking the period and inserting "; except that such section shall be applied without regard to subparagraph (B) thereof for purposes of applying this section and section 4979A with respect to securities acquired in a qualified gratuitous transfer (as defined in section 664(g)(1)).".

(15) Subsection (a) of section 4979A is amended to read as follows:

"(a) IMPOSITION OF TAX.—If—

"(1) there is a prohibited allocation of qualified securities by any employee stock ownership plan or eligible worker-owned cooperative, or

"(2) there is an allocation described in section 664(g)(5)(A),

there is hereby imposed a tax on such allocation equal to 50 percent of the amount involved.".

(16) Subsection (c) of section 4979A is amended to read as follows:

"(c) LIABILITY FOR TAX.—The tax imposed by this section shall be paid by—

"(1) the employer sponsoring such plan, or

"(2) the eligible worker-owned cooperative,

which made the written statement described in section 664(g)(1)(E) or in section 1042(b)(3)(B) (as the case may be).".

(17) Section 4979A is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) SPECIAL STATUTE OF LIMITATIONS FOR TAX ATTRIBUTABLE TO CERTAIN ALLOCATIONS.—The statutory period for the assessment of any tax imposed by this section on an allocation described in subsection (a)(2) of qualified employer securities shall not expire before the date which is 3 years from the later of—

"(1) the 1st allocation of such securities in connection with a qualified gratuitous transfer (as defined in section 664(g)(1)), or

"(2) the date on which the Secretary is notified of the allocation described in subsection (a)(2).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers made by trusts to, or for the use of, an employee stock ownership plan after the date of the enactment of this Act.

Subtitle C—Provisions Relating to Certain Health Acts

SEC. 1531. AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1986 TO IMPLEMENT THE NEWBORNS' AND MOTHERS' HEALTH PROTECTION ACT OF 1996 AND THE MENTAL HEALTH PARITY ACT OF 1996.

(a) IN GENERAL.—Subtitle K is amended—

(1) by striking all that precedes section 9801 and inserting the following:

"Subtitle K—Group Health Plan Requirements

"CHAPTER 100. Group health plan requirements.

"CHAPTER 100—GROUP HEALTH PLAN REQUIREMENTS

"Subchapter A. Requirements relating to portability, access, and renewability.
"Subchapter B. Other requirements.
"Subchapter C. General provisions.

"Subchapter A—Requirements Relating to Portability, Access, and Renewability

"Sec. 9801. Increased portability through limitation on preexisting condition exclusions.
"Sec. 9802. Prohibiting discrimination against individual participants and beneficiaries based on health status.
"Sec. 9803. Guaranteed renewability in multiemployer plans and certain multiple employer welfare arrangements.",

(2) by redesignating sections 9804, 9805, and 9806 as sections 9831, 9832, and 9833, respectively,

(3) by inserting before section 9831 (as so redesignated) the following:

"Subchapter C—General Provisions

"Sec. 9831. General exceptions.
"Sec. 9832. Definitions.
"Sec. 9833. Regulations.", and

(4) by inserting after section 9803 the following:

"Subchapter B—Other Requirements

"Sec. 9811. Standards relating to benefits for mothers and newborns.
"Sec. 9812. Parity in the application of certain limits to mental health benefits.

"SEC. 9811. STANDARDS RELATING TO BENEFITS FOR MOTHERS AND NEWBORNS.

"(a) REQUIREMENTS FOR MINIMUM HOSPITAL STAY FOLLOWING BIRTH.—

"(1) IN GENERAL.—A group health plan may not—

"(A) except as provided in paragraph (2)—

"(i) restrict benefits for any hospital length of stay in connection with childbirth for the mother or new-

born child, following a normal vaginal delivery, to less than 48 hours, or

"(ii) restrict benefits for any hospital length of stay in connection with childbirth for the mother or newborn child, following a caesarean section, to less than 96 hours; or

"(B) require that a provider obtain authorization from the plan or the issuer for prescribing any length of stay required under subparagraph (A) (without regard to paragraph (2)).

"(2) EXCEPTION.—Paragraph (1)(A) shall not apply in connection with any group health plan in any case in which the decision to discharge the mother or her newborn child prior to the expiration of the minimum length of stay otherwise required under paragraph (1)(A) is made by an attending provider in consultation with the mother.

"(b) PROHIBITIONS.—A group health plan may not—

"(1) deny to the mother or her newborn child eligibility, or continued eligibility, to enroll or to renew coverage under the terms of the plan, solely for the purpose of avoiding the requirements of this section;

"(2) provide monetary payments or rebates to mothers to encourage such mothers to accept less than the minimum protections available under this section;

"(3) penalize or otherwise reduce or limit the reimbursement of an attending provider because such provider provided care to an individual participant or beneficiary in accordance with this section;

"(4) provide incentives (monetary or otherwise) to an attending provider to induce such provider to provide care to an individual participant or beneficiary in a manner inconsistent with this section; or

"(5) subject to subsection (c)(3), restrict benefits for any portion of a period within a hospital length of stay required under subsection (a) in a manner which is less favorable than the benefits provided for any preceding portion of such stay.

"(c) RULES OF CONSTRUCTION.—

"(1) Nothing in this section shall be construed to require a mother who is a participant or beneficiary—

"(A) to give birth in a hospital; or

"(B) to stay in the hospital for a fixed period of time following the birth of her child.

"(2) This section shall not apply with respect to any group health plan which does not provide benefits for hospital lengths of stay in connection with childbirth for a mother or her newborn child.

"(3) Nothing in this section shall be construed as preventing a group health plan from imposing deductibles, coinsurance, or other cost-sharing in relation to benefits for hospital lengths of stay in connection with childbirth for a mother or newborn child under the plan, except that such coinsurance or other cost-sharing for any portion of a period within a hospital length of stay required under subsection (a) may not be greater

than such coinsurance or cost-sharing for any preceding portion of such stay.

"(d) LEVEL AND TYPE OF REIMBURSEMENTS.—Nothing in this section shall be construed to prevent a group health plan from negotiating the level and type of reimbursement with a provider for care provided in accordance with this section.

"(f) PREEMPTION; EXCEPTION FOR HEALTH INSURANCE COVERAGE IN CERTAIN STATES.—The requirements of this section shall not apply with respect to health insurance coverage if there is a State law (including a decision, rule, regulation, or other State action having the effect of law) for a State that regulates such coverage that is described in any of the following paragraphs:

"(1) Such State law requires such coverage to provide for at least a 48-hour hospital length of stay following a normal vaginal delivery and at least a 96-hour hospital length of stay following a caesarean section.

"(2) Such State law requires such coverage to provide for maternity and pediatric care in accordance with guidelines established by the American College of Obstetricians and Gynecologists, the American Academy of Pediatrics, or other established professional medical associations.

"(3) Such State law requires, in connection with such coverage for maternity care, that the hospital length of stay for such care is left to the decision of (or required to be made by) the attending provider in consultation with the mother.

"SEC. 9812. PARITY IN THE APPLICATION OF CERTAIN LIMITS TO MENTAL HEALTH BENEFITS.

"(a) IN GENERAL.—

"(1) AGGREGATE LIFETIME LIMITS.—In the case of a group health plan that provides both medical and surgical benefits and mental health benefits—

"(A) NO LIFETIME LIMIT.—If the plan does not include an aggregate lifetime limit on substantially all medical and surgical benefits, the plan may not impose any aggregate lifetime limit on mental health benefits.

"(B) LIFETIME LIMIT.—If the plan includes an aggregate lifetime limit on substantially all medical and surgical benefits (in this paragraph referred to as the 'applicable lifetime limit'), the plan shall either—

"(i) apply the applicable lifetime limit both to the medical and surgical benefits to which it otherwise would apply and to mental health benefits and not distinguish in the application of such limit between such medical and surgical benefits and mental health benefits; or

"(ii) not include any aggregate lifetime limit on mental health benefits that is less than the applicable lifetime limit.

"(C) RULE IN CASE OF DIFFERENT LIMITS.—In the case of a plan that is not described in subparagraph (A) or (B) and that includes no or different aggregate lifetime limits on different categories of medical and surgical benefits, the Secretary shall establish rules under which subparagraph (B) is applied to such plan with respect to mental health

benefits by substituting for the applicable lifetime limit an average aggregate lifetime limit that is computed taking into account the weighted average of the aggregate lifetime limits applicable to such categories.

"(2) ANNUAL LIMITS.—In the case of a group health plan that provides both medical and surgical benefits and mental health benefits—

"(A) NO ANNUAL LIMIT.—If the plan does not include an annual limit on substantially all medical and surgical benefits, the plan may not impose any annual limit on mental health benefits.

"(B) ANNUAL LIMIT.—If the plan includes an annual limit on substantially all medical and surgical benefits (in this paragraph referred to as the 'applicable annual limit'), the plan shall either—

"(i) apply the applicable annual limit both to medical and surgical benefits to which it otherwise would apply and to mental health benefits and not distinguish in the application of such limit between such medical and surgical benefits and mental health benefits; or

"(ii) not include any annual limit on mental health benefits that is less than the applicable annual limit.

"(C) RULE IN CASE OF DIFFERENT LIMITS.—In the case of a plan that is not described in subparagraph (A) or (B) and that includes no or different annual limits on different categories of medical and surgical benefits, the Secretary shall establish rules under which subparagraph (B) is applied to such plan with respect to mental health benefits by substituting for the applicable annual limit an average annual limit that is computed taking into account the weighted average of the annual limits applicable to such categories.

"(b) CONSTRUCTION.—Nothing in this section shall be construed—

"(1) as requiring a group health plan to provide any mental health benefits; or

"(2) in the case of a group health plan that provides mental health benefits, as affecting the terms and conditions (including cost sharing, limits on numbers of visits or days of coverage, and requirements relating to medical necessity) relating to the amount, duration, or scope of mental health benefits under the plan, except as specifically provided in subsection (a) (in regard to parity in the imposition of aggregate lifetime limits and annual limits for mental health benefits).

"(c) EXEMPTIONS.—

"(1) SMALL EMPLOYER EXEMPTION.—This section shall not apply to any group health plan for any plan year of a small employer (as defined in section 4980D(d)(2)).

"(2) INCREASED COST EXEMPTION.—This section shall not apply with respect to a group health plan if the application of this section to such plan results in an increase in the cost under the plan of at least 1 percent.

"(d) SEPARATE APPLICATION TO EACH OPTION OFFERED.—In the case of a group health plan that offers a participant or beneficiary two or more benefit package options under the plan, the requirements of this section shall be applied separately with respect to each such option.

"(e) DEFINITIONS.—For purposes of this section:

"(1) AGGREGATE LIFETIME LIMIT.—The term 'aggregate lifetime limit' means, with respect to benefits under a group health plan, a dollar limitation on the total amount that may be paid with respect to such benefits under the plan with respect to an individual or other coverage unit.

"(2) ANNUAL LIMIT.—The term 'annual limit' means, with respect to benefits under a group health plan, a dollar limitation on the total amount of benefits that may be paid with respect to such benefits in a 12-month period under the plan with respect to an individual or other coverage unit.

"(3) MEDICAL OR SURGICAL BENEFITS.—The term 'medical or surgical benefits' means benefits with respect to medical or surgical services, as defined under the terms of the plan, but does not include mental health benefits.

"(4) MENTAL HEALTH BENEFITS.—The term 'mental health benefits' means benefits with respect to mental health services, as defined under the terms of the plan, but does not include benefits with respect to treatment of substance abuse or chemical dependency.

"(f) SUNSET.—This section shall not apply to benefits for services furnished on or after September 30, 2001."

(b) CONFORMING AMENDMENTS.—

(1) Chapter 100 of such Code is further amended—

(A) in the last sentence of section 9801(c)(1), by striking "section 9805(c)" and inserting "section 9832(c)";

(B) in section 9831(b), by striking "9805(c)(1)" and inserting "9832(c)(1)";

(C) in section 9831(c)(1), by striking "9805(c)(2)" and inserting "9832(c)(2)";

(D) in section 9831(c)(2), by striking "9805(c)(3)" and inserting "9832(c)(3)"; and

(E) in section 9831(c)(3), by striking "9805(c)(4)" and inserting "9832(c)(4)".

(2) Section 4980D of such Code is amended—

(A) in subsection (a), by striking "plan portability, access, and renewability" and inserting "plans";

(B) in subsection (c)(3)(B)(i)(I), by striking "9805(d)(3)" and inserting "9832(d)(3)";

(C) in subsection (d)(1), by inserting "(other than a failure attributable to section 9811)" after "on any failure";

(D) in subsection (d)(3), by striking "9805" and inserting "9832";

(E) in subsection (f)(1), by striking "9805(a)" and inserting "9832(a)".

(3) The table of subtitles for such Code is amended by striking the item relating to subtitle K and inserting the following new item:

"SUBTITLE K. Group health plan requirements."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to group health plans for plan years beginning on or after January 1, 1998.

SEC. 1532. SPECIAL RULES RELATING TO CHURCH PLANS.

(a) IN GENERAL.—Section 9802 (relating to prohibiting discrimination against individual participants and beneficiaries based on health status) is amended by adding at the end the following new subsection:

"(c) SPECIAL RULES FOR CHURCH PLANS.—A church plan (as defined in section 414(e)) shall not be treated as failing to meet the requirements of this section solely because such plan requires evidence of good health for coverage of—

"(1) both any employee of an employer with 10 or less employees (determined without regard to section 414(e)(3)(C)) and any self-employed individual, or

"(2) any individual who enrolls after the first 90 days of initial eligibility under the plan.

This subsection shall apply to a plan for any year only if the plan included the provisions described in the preceding sentence on July 15, 1997, and at all times thereafter before the beginning of such year."

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall take effect as if included in the amendments made by section 401(a) of the Health Insurance Portability and Accountability Act of 1996.

Subtitle D—Provisions Relating to Plan Amendments

SEC. 1541. PROVISIONS RELATING TO PLAN AMENDMENTS.

(a) IN GENERAL.—If this section applies to any plan or contract amendment—

(1) such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subsection (b)(2)(A), and

(2) such plan shall not fail to meet the requirements of section 411(d)(6) of the Internal Revenue Code of 1986 or section 204(g) of the Employee Retirement Income Security Act of 1974 by reason of such amendment.

(b) AMENDMENTS TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—This section shall apply to any amendment to any plan or annuity contract which is made—

(A) pursuant to any amendment made by this title or subtitle H of title X, and

(B) before the first day of the first plan year beginning on or after January 1, 1999.

In the case of a governmental plan (as defined in section 414(d) of the Internal Revenue Code of 1986), this paragraph shall be applied by substituting "2001" for "1999".

(2) CONDITIONS.—This section shall not apply to any amendment unless—

(A) during the period—

(i) beginning on the date the legislative amendment described in paragraph (1)(A) takes effect (or in the case of a plan or contract amendment not required by such legislative amendment, the effective date specified by the plan), and

(ii) ending on the date described in paragraph (1)(B) (or, if earlier, the date the plan or contract amendment is adopted),

the plan or contract is operated as if such plan or contract amendment were in effect, and

(B) such plan or contract amendment applies retroactively for such period.

TITLE XVI—TECHNICAL AMENDMENTS RELATED TO SMALL BUSINESS JOB PROTECTION ACT OF 1996 AND OTHER LEGISLATION

SEC. 1600. COORDINATION WITH OTHER TITLES.

For purposes of applying the amendments made by any title of this Act other than this title, the provisions of this title shall be treated as having been enacted immediately before the provisions of such other titles.

SEC. 1601. AMENDMENTS RELATED TO SMALL BUSINESS JOB PROTECTION ACT OF 1996.

(a) AMENDMENTS RELATED TO SUBTITLE A.—

(1) AMENDMENT RELATED TO SECTION 1116.—Paragraph (1) of section 6050R(c) is amended by striking "name and address" and inserting "name, address, and phone number of the information contact".

(2) AMENDMENT TO SECTION 1116.—Paragraphs (1) and (2)(C) of section 1116(b) of the Small Business Job Protection Act of 1996 shall each be applied as if the reference to chapter 68 were a reference to chapter 61.

(b) AMENDMENT RELATED TO SUBTITLE B.—Subsection (c) of section 52 is amended by striking "targeted jobs credit" and inserting "work opportunity credit".

(c) AMENDMENTS RELATED TO SUBTITLE C.—

(1) AMENDMENT RELATED TO SECTION 1302.—Subparagraph (B) of section 1361(e)(1) is amended by striking "and" at the end of clause (i), striking the period at the end of clause (ii) and inserting ", and", and adding at the end the following new clause:

"(iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)).".

(2) EFFECTIVE DATE FOR SECTION 1307.—

(A) Notwithstanding section 1317 of the Small Business Job Protection Act of 1996, the amendments made by subsections (a) and (b) of section 1307 of such Act shall apply to determinations made after December 31, 1996.

(B) In no event shall the 120-day period referred to in section 1377(b)(1)(B) of the Internal Revenue Code of 1986

(as added by such section 1307) expire before the end of the 120-day period beginning on the date of the enactment of this Act.

(3) AMENDMENT RELATED TO SECTION 1308.—Subparagraph (A) of section 1361(b)(3) is amended by striking "For purposes of this title" and inserting "Except as provided in regulations prescribed by the Secretary, for purposes of this title".

(4) AMENDMENTS RELATED TO SECTION 1316.—

(A) Paragraph (2) of section 512(e) is amended by striking "within the meaning of section 1012" and inserting "as defined in section 1361(e)(1)(C)".

(B) Paragraph (7) of section 1361(c) is redesignated as paragraph (6).

(C) Subparagraph (B) of section 1361(b)(1) is amended by striking "subsection (c)(7)" and inserting "subsection (c)(6)".

(D) Paragraph (1) of section 512(e) is amended by striking "section 1361(c)(7)" and inserting "section 1361(c)(6)".

(d) AMENDMENTS RELATED TO SUBTITLE D.—

(1) AMENDMENTS RELATED TO SECTION 1421.—

(A) Subsection (i) of section 408 is amended in the last sentence by striking "30 days" and inserting "31 days".

(B) Subparagraph (H) of section 408(k)(6) is amended by striking "if the terms of such pension" and inserting "of an employer if the terms of simplified employee pensions of such employer".

(C)(i) Subparagraph (B) of section 408(l)(2) is amended—

(I) by inserting "and the issuer of an annuity established under such an arrangement" after "under subsection (p)", and

(II) in clause (i), by inserting "or issuer" after "trustee".

(ii) Paragraph (2) of section 6693(c) is amended—

(I) by inserting "or issuer" after "trustee", and

(II) in the heading, by inserting "AND ISSUER" after "trustee".

(D) Subsection (p) of section 408 is amended by adding at the end the following new paragraph:

"(8) COORDINATION WITH MAXIMUM LIMITATION UNDER SUBSECTION (a).—In the case of any simple retirement account, subsections (a)(1) and (b)(2) shall be applied by substituting 'the sum of the dollar amount in effect under paragraph (2)(A)(ii) of this subsection and the employer contribution required under subparagraph (A)(iii) or (B)(i) of paragraph (2) of this subsection, whichever is applicable' for '$2,000'.".

(E) Clause (i) of section 408(p)(2)(D) is amended by adding at the end the following new sentence: "If only individuals other than employees described in subparagraph (A) or (B) of section 410(b)(3) are eligible to participate in such arrangement, then the preceding sentence shall be applied without regard to any qualified plan in which only employees so described are eligible to participate.".

(F) Subparagraph (D) of section 408(p)(2) is amended by adding at the end the following new clause:

"(iii) GRACE PERIOD.—In the case of an employer who establishes and maintains a plan under this subsection for 1 or more years and who fails to meet any requirement of this subsection for any subsequent year due to any acquisition, disposition, or similar transaction involving another such employer, rules similar to the rules of section 410(b)(6)(C) shall apply for purposes of this subsection.".

(G) Paragraph (5) of section 408(p) is amended in the text preceding subparagraph (A) by striking "simplified" and inserting "simple".

(2) AMENDMENTS RELATED TO SECTION 1422.—

(A) Clause (ii) of section 401(k)(11)(D) is amended by striking the period and inserting "if such plan allows only contributions required under this paragraph.".

(B) Paragraph (11) of section 401(k) is amended by adding at the end the following new subparagraph:

"(E) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust the $6,000 amount under subparagraph (B)(i)(I) at the same time and in the same manner as under section 408(p)(2)(E).".

(C) Subparagraph (A) of section 404(a)(3) is amended—

(i) in clause (i), by striking "not in excess of" and all that follows and inserting the following: "not in excess of the greater of—

"(I) 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan, or

"(II) the amount such employer is required to contribute to such trust under section 401(k)(11) for such year.", and

(ii) in clause (ii), by striking "15 percent" and all that follows and inserting the following "the amount described in subclause (I) or (II) of clause (i), whichever is greater, with respect to such taxable year.".

(D) Subparagraph (B) of section 401(k)(11) is amended by adding at the end the following new clause:

"(iii) ADMINISTRATIVE REQUIREMENTS.—

"(I) IN GENERAL.—Rules similar to the rules of subparagraphs (B) and (C) of section 408(p)(5) shall apply for purposes of this subparagraph.

"(II) NOTICE OF ELECTION PERIOD.—The requirements of this subparagraph shall not be treated as met with respect to any year unless the employer notifies each employee eligible to participate, within a reasonable period of time before the 60th day before the beginning of such year (and, for the first year the employee is so eligible, the 60th day before the first day such employee is so eligible), of

the rules similar to the rules of section 408(p)(5)(C) which apply by reason of subclause (I).".

(3) AMENDMENT RELATED TO SECTION 1433.—The heading of paragraph (11) of section 401(m) is amended by striking "ALTERNATIVE" and inserting "ADDITIONAL ALTERNATIVE".

(4) CLARIFICATION OF SECTION 1450.—

(A) Section 403(b)(11) of the Internal Revenue Code of 1986 shall not apply with respect to a distribution from a contract described in section 1450(b)(1) of such Act to the extent that such distribution is not includible in income by reason of—

(i) in the case of distributions before January 1, 1998, section 403 (b)(8) or (b)(10) of such Code (determined after the application of section 1450(b)(2) of such Act), and

(ii) in the case of distributions on and after such date, such section 403(b)(1).

(B) This paragraph shall apply as if included in section 1450 of the Small Business Job Protection Act of 1996.

(5) AMENDMENT RELATED TO SECTION 1451.—Clause (ii) of section 205(c)(8)(A) of the Employee Retirement Income Security Act of 1974 is amended by striking "Secretary" and inserting "Secretary of the Treasury".

(6) AMENDMENTS RELATED TO SECTION 1461.—

(A) Section 414(e)(5)(A) is amended to read as follows:

"(A) CERTAIN MINISTERS MAY PARTICIPATE.—For purposes of this part—

"(i) IN GENERAL.—A duly ordained, commissioned, or licensed minister of a church is described in paragraph (3)(B) if, in connection with the exercise of their ministry, the minister—

"(I) is a self-employed individual (within the meaning of section 401(c)(1)(B)), or

"(II) is employed by an organization other than an organization which is described in section 501(c)(3) and with respect to which the minister shares common religious bonds.

"(ii) TREATMENT AS EMPLOYER AND EMPLOYEE.—For purposes of sections 403(b)(1)(A) and 404(a)(10), a minister described in clause (i)(I) shall be treated as employed by the minister's own employer which is an organization described in section 501(c)(3) and exempt from tax under section 501(a).".

(B) Section 403(b)(1)(A) is amended by striking "or" at the end of clause (i), by inserting "or" at the end of clause (ii), and by adding at the end the following new clause:

"(iii) for the minister described in section 414(e)(5)(A) by the minister or by an employer,".

(7) AMENDMENT RELATED TO SECTION 1462.—The paragraph (7) of section 414(q) added by section 1462 of the Small Business Job Protection Act of 1996 is redesignated as paragraph (9).

(e) AMENDMENT RELATED TO SUBTITLE E.—Subparagraph (A) of section 956(b)(1) is amended by inserting "to the extent such

amount was accumulated in prior taxable years" after "section 316(a)(1)".

(f) AMENDMENTS RELATED TO SUBTITLE F.—

(1) AMENDMENTS RELATED TO SECTION 1601.—

(A) The heading of section 30A is amended to read as follows:

"SEC. 30A. PUERTO RICO ECONOMIC ACTIVITY CREDIT.".

(B) The table of sections for subpart B of part IV of subchapter A of chapter 1 is amended in the item relating to section 30A by striking "Puerto Rican" and inserting "Puerto Rico".

(C) Paragraph (1) of section 55(c) is amended by striking "Puerto Rican" and inserting "Puerto Rico".

(2) AMENDMENTS RELATED TO SECTION 1606.—

(A) Clause (ii) of section 9503(c)(2)(A) is amended by striking "(or with respect to qualified diesel-powered highway vehicles purchased before January 1, 1999)".

(B) Subparagraph (A) of section 9503(e)(5) is amended by striking "; except that" and all that follows and inserting a period.

(3) AMENDMENTS RELATED TO SECTION 1607.—

(A) Subsection (f) of section 4001 (relating to phasedown of tax on luxury passenger automobiles) is amended—

(i) by inserting "and section 4003(a)" after "subsection (a)", and

(ii) by inserting ", each place it appears," before "the percentage".

(B) Subsection (g) of section 4001 (relating to termination) is amended by striking "tax imposed by this section" and inserting "taxes imposed by this section and section 4003" and by striking "or use" and inserting ", use, or installation".

(C) The amendments made by this paragraph shall apply to sales after the date of the enactment of this Act.

(4) AMENDMENTS RELATED TO SECTION 1609.—

(A) Subsection (l) of section 4041 is amended—

(i) by inserting "or a fixed-wing aircraft" after "helicopter", and

(ii) in the heading, by striking "HELICOPTER".

(B) The last sentence of section 4041(a)(2) is amended by striking "section 4081(a)(2)(A)" and inserting "section 4081(a)(2)(A)(i)".

(C) Subsection (b) of section 4092 is amended by striking "section 4041(c)(4)" and inserting "section 4041(c)(2)".

(D) Subsection (g) of section 4261 (as redesignated by title X) is amended by inserting "on that flight" after "dedicated".

(E) Paragraph (1) of section 1609(h) of such Act is amended by striking "paragraph (3)(A)(i)" and inserting "paragraph (3)(A)".

(F) Paragraph (4) of section 1609(h) of such Act is amended by inserting before the period "or exclusively for the use described in section 4092(b) of such Code".

(5) AMENDMENTS RELATED TO SECTION 1616.—

(A) Subparagraph (A) of section 593(e)(1) is amended by inserting "(and, in the case of an S corporation, the accumulated adjustments account, as defined in section 1368(e)(1))" after "1951,".

(B) Paragraph (7) of section 1374(d) is amended by adding at the end the following new sentence: "For purposes of applying this section to any amount includible in income by reason of section 593(e), the preceding sentence shall be applied without regard to the phrase '10-year'.".

(6) AMENDMENTS RELATED TO SECTION 1621.—

(A) Subparagraph (A) of section 860L(b)(1) is amended in the text preceding clause (i) by striking "after the startup date" and inserting "on or after the startup date".

(B) Paragraph (2) of section 860L(d) is amended by striking "section 860I(c)(2)" and inserting "section 860I(b)(2)".

(C) Subparagraph (B) of section 860L(e)(2) is amended by inserting "other than foreclosure property" after "any permitted asset".

(D) Subparagraph (A) of section 860L(e)(3) is amended by striking "if the FASIT" and all that follows and inserting the following new flush text after clause (ii):

"if the FASIT were treated as a REMIC and permitted assets (other than cash or cash equivalents) were treated as qualified mortgages.".

(E)(i) Paragraph (3) of section 860L(e) is amended by adding at the end the following new subparagraph:

"(D) INCOME FROM DISPOSITIONS OF FORMER HEDGE ASSETS.—Paragraph (2)(A) shall not apply to income derived from the disposition of—

"(i) an asset which was described in subsection (c)(1)(D) when first acquired by the FASIT but on the date of such disposition was no longer described in subsection (c)(1)(D)(ii), or

"(ii) a contract right to acquire an asset described in clause (i).".

(ii) Subparagraph (A) of section 860L(e)(2) is amended by inserting "except as provided in paragraph (3)," before "the receipt".

(g) AMENDMENTS RELATED TO SUBTITLE G.—

(1) EXTENSION OF PERIOD FOR CLAIMING REFUNDS FOR ALCOHOL FUELS.—Notwithstanding section 6427(i)(3)(C) of the Internal Revenue Code of 1986, a claim filed under section 6427(f) of such Code for any period after September 30, 1995, and before October 1, 1996, shall be treated as timely filed if filed before the 60th day after the date of the enactment of this Act.

(2) AMENDMENTS TO SECTIONS 1703 AND 1704.—Sections 1703(n)(8) and 1704(j)(4)(B) of the Small Business Job Protection Act of 1996 shall each be applied as if such sections referred to section 1702 instead of section 1602.

(h) AMENDMENTS RELATED TO SUBTITLE H.—

(1) AMENDMENTS RELATED TO SECTION 1806.—

(A) Subparagraph (B) of section 529(e)(1) is amended by striking "subsection (c)(2)(C)" and inserting "subsection (c)(3)(C)".

(B) Subparagraph (C) of section 529(e)(1) is amended by inserting "(or agency or instrumentality thereof)" after "local government".

(C) Paragraph (2) of section 1806(c) of the Small Business Job Protection Act of 1996 is amended by striking so much of the first sentence as follows subparagraph (B)(ii) and inserting the following:

"then such program (as in effect on August 20, 1996) shall be treated as a qualified State tuition program with respect to contributions (and earnings allocable thereto) pursuant to contracts entered into under such program before the first date on which such program meets such requirements (determined without regard to this paragraph) and the provisions of such program (as so in effect) shall apply in lieu of section 529(b) of the Internal Revenue Code of 1986 with respect to such contributions and earnings.".

(2) AMENDMENTS RELATED TO SECTION 1807.—

(A) Paragraph (2) of section 23(a) is amended to read as follows:

"(2) YEAR CREDIT ALLOWED.—The credit under paragraph (1) with respect to any expense shall be allowed—

"(A) in the case of any expense paid or incurred before the taxable year in which such adoption becomes final, for the taxable year following the taxable year during which such expense is paid or incurred, and

"(B) in the case of an expense paid or incurred during or after the taxable year in which such adoption becomes final, for the taxable year in which such expense is paid or incurred.".

(B) Subparagraph (B) of section 23(b)(2) is amended by striking "determined—" and all that follows and inserting the following: "determined without regard to sections 911, 931, and 933.".

(C) Paragraph (1) of section 137(b) (relating to adoption assistance programs) is amended by striking "amount excludable from gross income" and inserting "of the amounts paid or expenses incurred which may be taken into account".

(D)(i) Subparagraph (C) of section 414(n)(3) is amended by inserting "137," after "132,".

(ii) Paragraph (2) of section 414(t) is amended by inserting "137," after "132,".

(iii) Paragraph (1) of section 6039D(d) is amended by striking "or 129" and inserting "129, or 137".

(i) AMENDMENTS RELATED TO SUBTITLE I.—

(1) AMENDMENT RELATED TO SECTION 1901.—Subsection (b) of section 6048 is amended in the heading by striking "GRANTOR" and inserting "OWNER".

(2) AMENDMENTS RELATED TO SECTION 1903.—

Clauses (ii) and (iii) of section 679(a)(3)(C) are each amended by inserting ", owner," after "grantor".

(3) AMENDMENTS RELATED TO SECTION 1907.—

(A) Clause (ii) of section 7701(a)(30)(E) is amended by striking "fiduciaries" and inserting "persons".

(B) Subsection (b) of section 641 is amended by adding at the end the following new sentence: "For purposes of this subsection, a foreign trust or foreign estate shall be treated as a nonresident alien individual who is not present in the United States at any time.".

(4) EFFECTIVE DATE RELATED TO SUBTITLE I.—The Secretary of the Treasury may by regulations or other administrative guidance provide that the amendments made by section 1907(a) of the Small Business Job Protection Act of 1996 shall not apply to a trust with respect to a reasonable period beginning on the date of the enactment of such Act, if—

(A) such trust is in existence on August 20, 1996, and is a United States person for purposes of the Internal Revenue Code of 1986 on such date (determined without regard to such amendments),

(B) no election is in effect under section 1907(a)(3)(B) of such Act with respect to such trust,

(C) before the expiration of such reasonable period, such trust makes the modifications necessary to be treated as a United States person for purposes of such Code (determined with regard to such amendments), and

(D) such trust meets such other conditions as the Secretary may require.

(j) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect as if included in the provisions of the Small Business Job Protection Act of 1996 to which they relate.

(2) CERTAIN ADMINISTRATIVE REQUIREMENTS WITH RESPECT TO CERTAIN PENSION PLANS.—The amendment made by subsection (d)(2)(D) shall apply to calendar years beginning after the date of the enactment of this Act.

SEC. 1602. AMENDMENTS RELATED TO HEALTH INSURANCE PORTABILITY AND ACCOUNTABILITY ACT OF 1996.

(a) AMENDMENTS RELATED TO SECTION 301.—

(1) Paragraph (2) of section 26(b) is amended by striking "and" at the end of subparagraph (N), by striking the period at the end of subparagraph (O) and inserting ", and", and by adding at the end the following new subparagraph:

"(P) section 220(f)(4) (relating to additional tax on medical savings account distributions not used for qualified medical expenses).".

(2) Paragraph (3) of section 220(c) is amended by striking subparagraph (A) and redesignating subparagraphs (B) through (D) as subparagraphs (A) through (C), respectively.

(3) Subparagraph (C) of section 220(d)(2) is amended by striking "an eligible individual" and inserting "described in clauses (i) and (ii) of subsection (c)(1)(A)".

(4) Subsection (a) of section 6693 is amended by adding at the end the following new sentence:

"This subsection shall not apply to any report which is an information return described in section 6724(d)(1)(C)(i) or a payee statement described in section 6724(d)(2)(X).".

(5) Paragraph (4) of section 4975(c) is amended by striking "if, with respect to such transaction" and all that follows and inserting the following: "if section 220(e)(2) applies to such transaction.".

(b) AMENDMENT RELATED TO SECTION 321.—Subparagraph (B) of section 7702B(c)(2) is amended in the last sentence by inserting "described in subparagraph (A)(i)" after "chronically ill individual".

(c) AMENDMENTS RELATED TO SECTION 322.—Subparagraph (B) of section 162(l)(2) is amended by adding at the end the following new sentence: "The preceding sentence shall be applied separately with respect to—

"(i) plans which include coverage for qualified long-term care services (as defined in section 7702B(c)) or are qualified long-term care insurance contracts (as defined in section 7702B(b)), and

"(ii) plans which do not include such coverage and are not such contracts.".

(d) AMENDMENTS RELATED TO SECTION 323.—

(1) Paragraph (1) of section 6050Q(b) is amended by inserting ", address, and phone number of the information contact" after "name".

(2)(A) Paragraph (2) of section 6724(d) is amended by striking so much as follows subparagraph (Q) and precedes the last sentence, and inserting the following new subparagraphs:

"(R) section 6050R(c) (relating to returns relating to certain purchases of fish),

"(S) section 6051 (relating to receipts for employees),

"(T) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance),

"(U) section 6053(b) or (c) (relating to reports of tips),

"(V) section 6048(b)(1)(B) (relating to foreign trust reporting requirements),

"(W) section 4093(c)(4)(B) (relating to certain purchasers of diesel and aviation fuels),

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

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

(B) Subsection (e) of section 6652 is amended in the last sentence by striking "section 6724(d)(2)(X)" and inserting "section 6724(d)(2)(Y)".

(e) AMENDMENT RELATED TO SECTION 325.—Clauses (ii) and (iii) of section 7702B(g)(4)(B) are each amended by striking "Secretary" and inserting "appropriate State regulatory agency".

(f) AMENDMENTS RELATED TO SECTION 501.—

(1) Paragraph (4) of section 264(a) is amended by striking subparagraph (A) and all that follows through "by the taxpayer." and inserting the following:

"(A) is or was an officer or employee, or

"(B) is or was financially interested in,

any trade or business carried on (currently or formerly) by the taxpayer.".

(2) The last 2 sentences of section 264(d)(2)(B)(ii) are amended to read as follows:

"For purposes of subclause (II), the term 'applicable period' means the 12-month period beginning on the date the policy is issued (and each successive 12-month period thereafter) unless the taxpayer elects a number of months (not greater than 12) other than such 12-month period to be its applicable period. Such an election shall be made not later than the 90th day after the date of the enactment of this sentence and, if made, shall apply to the taxpayer's first taxable year ending on or after October 13, 1995, and all subsequent taxable years unless revoked with the consent of the Secretary.".

(3) Subparagraph (B) of section 264(d)(4) is amended by striking "the employer" and inserting "the taxpayer".

(4) Subsection (c) of section 501 of the Health Insurance Portability and Accountability Act of 1996 is amended by striking paragraph (3).

(5) Paragraph (2) of section 501(d) of such Act is amended by striking "no additional premiums" and all that follows and inserting the following: "a lapse occurring after October 13, 1995, by reason of no additional premiums being received under the contract.".

(g) AMENDMENTS RELATED TO SECTION 511.—

(1) Subparagraph (B) of section 877(d)(2) is amended by striking "the 10-year period described in subsection (a)" and inserting "the 10-year period beginning on the date the individual loses United States citizenship".

(2) Subparagraph (D) of section 877(d)(2) is amended by adding at the end the following new sentence: "In the case of any exchange occurring during such 5 years, any gain recognized under this subparagraph shall be recognized immediately after such loss of citizenship.".

(3) Paragraph (3) of section 877(d) is amended by inserting "and the period applicable under paragraph (2)" after "subsection (a)".

(4) Subparagraph (A) of section 877(d)(4) is amended—

(A) by inserting "during the 10-year period beginning on the date the individual loses United States citizenship" after "contributes property" in clause (i),

(B) by inserting "immediately before such contribution" after "from such property", and

(C) by striking "during the 10-year period referred to in subsection (a),".

(5) Subparagraph (C) of section 2501(a)(3) is amended by striking "decedent" and inserting "donor".

(6)(A) Clause (i) of section 2107(c)(2)(B) is amended by striking "such foreign country in respect of property included in the gross estate as the value of the property" and inserting

"such foreign country as the value of the property subjected to such taxes by such foreign country and".

(B) Subparagraph (C) of section 2107(c)(2) is amended to read as follows:

"(C) PROPORTIONATE SHARE.—In the case of property which is included in the gross estate solely by reason of subsection (b), such property's proportionate share is the percentage which the value of such property bears to the total value of all property included in the gross estate solely by reason of subsection (b).".

(h) AMENDMENTS RELATED TO SECTION 512.—

(1) Subpart A of part III of subchapter A of chapter 61 is amended by redesignating the section 6039F added by section 512 of the Health Insurance Portability and Accountability Act of 1996 as section 6039G and by moving such section 6039G to immediately after the section 6039F added by section 1905 of the Small Business Job Protection Act of 1996.

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking the item relating to the section 6039F related to information on individuals losing United States citizenship and inserting after the item relating to the section 6039F related to notice of large gifts received from foreign persons the following new item:

"Sec. 6039G. Information on individuals losing United States citizenship.".

(3) Paragraph (1) of section 877(e) is amended by striking "6039F" and inserting "6039G".

(i) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Health Insurance Portability and Accountability Act of 1996 to which such amendments relate.

SEC. 1603. AMENDMENTS RELATED TO TAXPAYER BILL OF RIGHTS 2.

(a) AMENDMENT RELATED TO SECTION 1311.—Subsection (b) of section 4962 is amended by striking "subchapter A or C" and inserting "subchapter A, C, or D".

(b) AMENDMENTS RELATED TO SECTION 1312.—

(1)(A) Paragraph (10) of section 6033(b) is amended by striking all that precedes subparagraph (A) and inserting the following:

"(10) the respective amounts (if any) of the taxes imposed on the organization, or any organization manager of the organization, during the taxable year under any of the following provisions (and the respective amounts (if any) of reimbursements paid by the organization during the taxable year with respect to taxes imposed on any such organization manager under any of such provisions):".

(B) Subparagraph (C) of section 6033(b)(10) is amended by adding at the end the following: "except to the extent that, by reason of section 4962, the taxes imposed under such section are not required to be paid or are credited or refunded,".

(2) Paragraph (11) of section 6033(b) is amended to read as follows:

"(11) the respective amounts (if any) of—

"(A) the taxes imposed with respect to the organization on any organization manager, or any disqualified person, during the taxable year under section 4958 (relating to taxes on private excess benefit from certain charitable organizations), and

"(B) reimbursements paid by the organization during the taxable year with respect to taxes imposed under such section,

except to the extent that, by reason of section 4962, the taxes imposed under such section are not required to be paid or are credited or refunded,".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Taxpayer Bill of Rights 2 to which such amendments relate.

SEC. 1604. MISCELLANEOUS PROVISIONS.

(a) AMENDMENTS RELATED TO ENERGY POLICY ACT OF 1992.—

(1) Paragraph (1) of section 263(a) is amended by striking "or" at the end of subparagraph (F), by striking the period at the end of subparagraph (G) and inserting "; or", and by adding at the end the following new subparagraph:

"(H) expenditures for which a deduction is allowed under section 179A.".

(2) Subparagraph (B) of section 312(k)(3) is amended—

(A) by striking "179" in the heading and the first place it appears in the text and inserting "179 or 179A", and

(B) by striking "179" the last place it appears and inserting "179 or 179A, as the case may be".

(3) Paragraphs (2)(C) and (3)(C) of section 1245(a) are each amended by inserting "179A," after "179,".

(4) The amendments made by this subsection shall take effect as if included in the amendments made by section 1913 of the Energy Policy Act of 1992.

(b) AMENDMENTS RELATED TO URUGUAY ROUND AGREEMENTS ACT.—

(1) Paragraph (1) of section 6621(a) is amended in the last sentence by striking "subsection (c)(3))" and inserting "subsection (c)(3), applied by substituting 'overpayment' for 'underpayment')".

(2)(A) Subclause (II) of section 412(m)(5)(E)(ii) is amended by striking "clause (i)" and inserting "subclause (I)".

(B) Subclause (II) of section 302(e)(5)(E)(ii) of the Employee Retirement Income Security Act of 1974 is amended by striking "clause (i)" and inserting "subclause (I)".

(3) Subparagraph (A) of section 767(d)(3) of the Uruguay Round Agreements Act is amended in the last sentence by striking "(except that" and all that follows through "into account)".

(4) The amendments made by this subsection shall take effect as if included in the sections of the Uruguay Round Agreements Act to which they relate.

(c) AMENDMENT RELATED TO OMNIBUS BUDGET RECONCILIATION ACT OF 1993.—

(1) Paragraph (6) of section 168(j) (defining Indian reservation) is amended by adding at the end the following new flush sentence:

"For purposes of the preceding sentence, such section 3(d) shall be applied by treating the term 'former Indian reservations in Oklahoma' as including only lands which are within the jurisdictional area of an Oklahoma Indian tribe (as determined by the Secretary of the Interior) and are recognized by such Secretary as eligible for trust land status under 25 CFR Part 151 (as in effect on the date of the enactment of this sentence).".

(2) The amendment made by paragraph (1) shall apply as if included in the amendments made by section 13321 of the Omnibus Budget Reconciliation Act of 1993, except that such amendment shall not apply—

(A) with respect to property (with an applicable recovery period under section 168(j) of the Internal Revenue Code of 1986 of 6 years or less) held by the taxpayer if the taxpayer claimed the benefits of section 168(j) of such Code with respect to such property on a return filed before March 18, 1997, but only if such return is the first return of tax filed for the taxable year in which such property was placed in service, or

(B) with respect to wages for which the taxpayer claimed the benefits of section 45A of such Code for a taxable year on a return filed before March 18, 1997, but only if such return was the first return of tax filed for such taxable year.

(d) AMENDMENTS RELATED TO TAX REFORM ACT OF 1986.—

(1) Paragraph (3) of section 1059(d) is amended by striking "subsection (a)(2)" and inserting "subsection (a)".

(2)(A) Subparagraph (A) of section 833(b)(1) is amended—

(i) by inserting before the comma at the end of clause (i) "and liabilities incurred during the taxable year under cost-plus contracts", and

(ii) by inserting before the comma at the end of clause (ii) "or in connection with the administration of cost-plus contracts".

(B) The amendment made by subparagraph (A) shall take effect as if included in the amendments made by section 1012 of the Tax Reform Act of 1986.

(e) AMENDMENT RELATED TO TAX REFORM ACT OF 1984.—

(1) Section 267(f) is amended by adding at the end the following new paragraph:

"(4) DETERMINATION OF RELATIONSHIP RESULTING IN DISALLOWANCE OF LOSS, FOR PURPOSES OF OTHER PROVISIONS.—For purposes of any other section of this title which refers to a relationship which would result in a disallowance of losses under this section, deferral under paragraph (2) shall be treated as disallowance.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect as if included in section 174(b) of the Tax Reform Act of 1984.

(f) AMENDMENTS RELATED TO BALANCED BUDGET ACT OF 1997.—

(1) The Balanced Budget Act of 1997 is amended—

(A) in the table of contents for title IV, in the item relating to section 4921, by striking "children with";

*(B) in the heading for section 4921, by striking "**children with**"; and*

(C) in the section added by section 4921—

*(i) in the heading for such section, by striking "**children with**"; and*

(ii) by amending subsection (a) to read as follows:

"(a) IN GENERAL.—The Secretary, directly or through grants, shall provide for research into the prevention and cure of Type I diabetes.".

(2)(A) Section 11201(g)(2)(B)(iii) of the Balanced Budget Act of 1997 shall apply as if the reference in such section to "December 31, 2003" were a reference to "December 31, 2001".

(B) Notwithstanding section 11104(b)(3) of the Balanced Budget Act of 1997, in carrying out any of the management reform plans under such section, the head of a department of the government of the District of Columbia shall report solely to the District of Columbia Financial Responsibility and Management Assistance Authority.

(3) Section 9302 of the Balanced Budget Act of 1997 is amended by adding at the end the following new subsection:

"(k) COORDINATION WITH TOBACCO INDUSTRY SETTLEMENT AGREEMENT.—The increase in excise taxes collected as a result of the amendments made by subsections (a), (e), and (g) of this section shall be credited against the total payments made by parties pursuant to Federal legislation implementing the tobacco industry settlement agreement of June 20, 1997.

(4) The provisions of, and amendments made by, this subsection shall take effect immediately after the sections referred to in this subsection take effect.

(g) CLERICAL AMENDMENTS.—

(1) Clause (iii) of section 163(j)(2)(B) is amended by striking "clause (i)" and inserting "clause (ii)".

(2) Paragraph (1) of section 665(d) is amended in the last sentence by striking "or 669 (d) and (e)".

(3) Subsection (g) of section 1441 (relating to cross reference) is amended by striking "one-half" and inserting "85 percent".

(4) Paragraph (1) of section 2523(g) is amended by striking "qualified remainder trust" and inserting "qualified charitable remainder trust".

(5) Subsection (d) of section 9502 is amended by redesignating the paragraph added by section 806 of the Federal Aviation Reauthorization Act of 1996 as paragraph (6).

TITLE XVII—IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO

SEC. 1701. IDENTIFICATION OF LIMITED TAX BENEFITS SUBJECT TO LINE ITEM VETO.

Section 1021(a)(3) of the Congressional Budget and Impoundment Control Act of 1974 shall only apply to—

(1) section 101(c) (relating to high risk pools permitted to cover dependents of high risk individuals);

(2) section 222 (relating to limitation on qualified 501(c)(3) bonds other than hospital bonds);

(3) section 224 (relating to contributions of computer technology and equipment for elementary or secondary school purposes);

(4) section 312(a) (relating to treatment of remainder interests for purposes of provision relating to gain on sale of principal residence);

(5) section 501(b) (relating to indexing of alternative valuation of certain farm, etc., real property);

(6) section 504 (relating to extension of treatment of certain rents under section 2032A to lineal descendants);

(7) section 505 (relating to clarification of judicial review of eligibility for extension of time for payment of estate tax);

(8) section 508 (relating to treatment of land subject to qualified conservation easement);

(9) section 511 (relating to expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents);

(10) section 601 (relating to the research tax credit);

(11) section 602 (relating to contributions of stock to private foundations);

(12) section 603 (relating to the work opportunity tax credit);

(13) section 604 (relating to orphan drug tax credit);

(14) section 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create sections 1400 and 1400A (relating to tax-exempt economic development bonds);

(15) section 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create section 1400C (relating to first-time homebuyer credit for District of Columbia);

(16) section 801 (relating to incentives for employing long-term family assistance recipients);

(17) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens;

(18) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against measles;

(19) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against mumps;

(20) section 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against rubella;

(21) section 905 (relating to operators of multiple retail gasoline outlets treated as wholesale distributors for refund purposes);

(22) section 906 (relating to exemption of electric and other clean-fuel motor vehicles from luxury automobile classification);

(23) section 907(a) (relating to rate of tax on liquefied natural gas determined on basis of BTU equivalency with gasoline);

(24) section 907(b) (relating to rate of tax on methanol from natural gas determined on basis of BTU equivalency with gasoline);

(25) section 908 (relating to modification of tax treatment of hard cider);

(26) section 914 (relating to mortgage financing for residences located in disaster areas);

(27) section 962 (relating to assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments);

(28) section 963 (relating to tax-exempt status for certain State worker's compensation act companies);

(29) section 967 (relating to additional advance refunding of certain Virgin Island bonds);

(30) section 968 (relating to nonrecognition of gain on sale of stock to certain farmers' cooperatives);

(31) section 971 (relating to exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles);

(32) section 974 (relating to clarification of treatment of certain receivables purchased by cooperative hospital service organizations);

(33) section 975 (relating to deduction in computing adjusted gross income for expenses in connection with service performed by certain officials) with respect to taxable years beginning before 1991;

(34) section 977 (relating to elective carryback of existing carryovers of National Railroad Passenger Corporation);

(35) section 1005(b)(2)(B) (relating to transition rule for instruments described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997);

(36) section 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a public announcement;

(37) section 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission;

(38) section 1011(d)(2)(B) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on May 3, 1995);

(39) section 1011(d)(3) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on September 13, 1995);

(40) section 1012(d)(3)(B) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a ruling request submitted to the Internal Revenue Service on or before April 16, 1997);

(41) section 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a public announcement;

(42) section 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission;

(43) section 1013(d)(2)(B) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a ruling request submitted to the Internal Revenue Service submitted on or before June 8, 1997);

(44) section 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement;

(45) section 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission;

(46) section 1014(f)(2)(B) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997);

(47) section 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement;

(48) section 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission;

(49) section 1042(b) (relating to special rules for provision terminating certain exceptions from rules relating to exempt organizations which provide commercial-type insurance);

(50) section 1081(a) (relating to termination of suspense accounts for family corporations required to use accrual method of accounting) as it relates to the repeal of Internal Revenue Code section 447(i)(3);

(51) section 1089(b)(3) (relating to reformations);

(52) section 1089(b)(5)(B)(i) (relating to persons under a mental disability);

(53) section 1171 (relating to treatment of computer software as FSC export property);

(54) section 1175 (relating to exemption for active financing income);

(55) section 1204 (relating to travel expenses of certain Federal employees engaged in criminal investigations);

(56) section 1236 (relating to extension of time for filing a request for administrative adjustment);

(57) section 1243 (relating to special rules for administrative adjustment request with respect to bad debts or worthless securities);

(58) section 1251 (relating to clarification of limitation on maximum number of shareholders);

(59) section 1253 (relating to attribution rules applicable to stock ownership);

(60) section 1256 (relating to modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT year);

(61) section 1257 (relating to treatment of foreclosure property);

(62) section 1261 (relating to shared appreciation mortgages);

(63) section 1302 (relating to clarification of waiver of certain rights of recovery);

(64) section 1303 (relating to transitional rule under section 2056A);

(65) section 1304 (relating to treatment for estate tax purposes of short-term obligations held by nonresident aliens);

(66) section 1311 (relating to clarification of treatment of survivor annuities under qualified terminable interest rules);

(67) section 1312 (relating to treatment of qualified domestic trust rules of forms of ownership which are not trusts);

(68) section 1313 (relating to opportunity to correct failures under section 2032A);

(69) section 1414 (relating to fermented material from any brewery may be received at a distilled spirits plant);

(70) section 1417 (relating to use of additional ameliorating material in certain wines);

(71) section 1418 (relating to domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.);

(72) section 1421 (relating to transfer to brewery of beer imported in bulk without payment of tax);

(73) section 1422 (relating to transfer to bonded wine cellars of wine imported in bulk without payment of tax);

(74) section 1506 (relating to clarification of certain rules relating to employee stock ownership plans of S corporations);

(75) section 1507 (relating to modification of 10-percent tax for nondeductible contributions);

(76) section 1523 (relating to repeal of application of unrelated business income tax to ESOPs);

(77) section 1530 (relating to gratuitous transfers for the benefit of employees);

(78) section 1532 (relating to special rules relating to church plans); and

(79) section 1604(c)(2) (relating to amendment related to Omnibus Budget Reconciliation Act of 1993).

For consideration of the House bill, and the Senate amendment, and modifications committed to conference:

JOHN R. KASICH,
BILL ARCHER,
PHIL CRANE,
WILLIAM M. THOMAS,
DICK ARMEY,
TOM DELAY,
CHARLES B. RANGEL,

As additional conferees from the Committee on Transportation and Infrastructure, for consideration of secs. 702 and 704 of the Senate amendment, and modifications committed to conference:

BUD SHUSTER,
SUSAN MOLINARI,
JAMES L. OBERSTAR,

As additional conferees from the Committee on Education and the Workforce, for consideration of secs. 713–14, 717, 879, 1302, 1304–5, and 1311 of the Senate amendment, and modifications committed to conference:

BILL GOODLING,
HARRIS W. FAWELL,
DONALD M. PAYNE,

Managers on the Part of the House.

From the Committee on Finance:

BILL ROTH,
TRENT LOTT,
DANIEL P. MOYNIHAN,

From the Committee on the Budget:

PETE DOMENICI,
DON NICKLES,
FRANK R. LAUTENBERG,

Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2014) to provide for reconciliation pursuant to subsections (b)(2) and (d) of section 105 of the concurrent resolution on the budget for fiscal year 1998, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clerical changes.

I. CHILD AND DEPENDENT CARE TAX CREDIT; HEALTH CARE FOR CHILDREN

A. Child Tax Credit (sec. 101 (a), (c), and (d) of the House bill and sec. 101 of the Senate amendment)

Present Law

In general

Present law does not provide tax credits based solely on the taxpayer's 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 $2,650 for 1997, and is adjusted annually for inflation. In 1997, the amount of the personal exemption is phased out for taxpayers with AGI in excess of $121,200 for single taxpayers, $151,500 for heads of household, and $181,800 for married couples filing joint returns. These phaseout thresholds are adjusted annually for inflation.

Dependent care credit

A nonrefundable credit against income tax liability is available for up to 30 percent (phased down to 20 percent for individuals with AGI above $28,000) of a limited dollar amount of employment-related child and dependent care expenses for certain qualified individuals: (1) a dependent child under age 13; (2) a dependent physically or mentally unable to care for him or herself; or (3) a spouse who is physically or mentally unable to care for him or herself. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual and $4,800 if there are two or more qualifying individuals. Employment-related expenses are expenses for household services and the care of a qualifying individual, if incurred to enable the taxpayer to be gainfully employed. Employment-related expenses are reduced to the extent the taxpayer has employer-provided dependent care assistance that is excludable from gross income.

House Bill

Size of credit

The House bill provides a $500 ($400 for taxable year 1998) nonrefundable tax credit for each qualifying child under the age of 17.

Qualifying child

A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer.

Savings requirement

No provision.

Reduction for dependent care credit

After 1999, the child credit is reduced by one-half of the dependent care credit (no reduction with respect to dependents who are physically or mentally incapable of self-care). The reduction applies to married individuals with AGI above $60,000 ($30,000 for married individuals filing separately). In the case taxpayer's filing as a single or head of household, the reduction applies to AGI above $33,000.

Phaseout of credit

For taxpayers with modified AGI in excess of certain thresholds, the sum of the otherwise allowable child credit and the otherwise allowable dependent care credit is phased out. The phaseout rate is $25 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. The reduction is applied first to the child credit and then to the dependent care credit. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation.

Maximum allowable child credit

The maximum amount of the child credit for each taxable year (after the reduction, if any, for the dependent care credit after 2001) could not exceed an amount equal to the excess of: (1) the taxpayer's regular income tax liability (net of applicable credits) over (2) the sum of the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) and the earned income credit allowed.

IRS notice and withholding

The House bill provides that the Secretary of the Treasury shall submit notice to all taxpayers of the passage of the child tax credit. In addition, it directs the Secretary of the Treasury to modify the withholding tables for single taxpayers claiming more than one exemption and for married taxpayers claiming more than two exemptions to take account of the effects of the child tax credit. The adjustments to the withholding tables apply to employees whose annualized wages from an employer are expected to be at least $30,000, but not more than $100,000.

Effective date

Generally, the child tax credit is effective for taxable years beginning after December 31, 1997. The provision to reduce the other-wise allowable child credit by one-half of the amount of the taxpayer's dependent care credit is effective for taxable years beginning after December 31, 2001.

Senate Amendment

Size of credit

The Senate amendment provides a $500 ($250 in 1997 for children under the age of 13) nonrefundable tax credit for each qualifying child under the age of 17. For taxable years beginning after December 31, 2002, the credit is allowed for each qualifying child under the age of 18.

Qualifying child

Same as the House bill.

Savings requirement

In the case of each child age 13 to 16 (13 to 17 for taxable years beginning after December 31, 2002), the credit generally is available only for amounts contributed to savings for education with respect to that child.

Reduction for dependent care credit

No provision.

Phaseout

Generally the same as the House bill, except the dependent care credit is not phased out.

Maximum allowable child credit

The maximum amount of the child credit for each taxable year cannot exceed an amount equal to the excess of: (1) the taxpayer's regular income tax liability (net of applicable credits) over (2) the sum of the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) and one-half of the earned income credit allowed.

IRS notice and withholding

No provision.

Effective date

The child tax credit is effective July 1, 1997, for taxable years beginning after December 31, 1996.

Conference Agreement

Size of credit

The conference agreement provides a $500 ($400 for taxable year 1998) credit for each qualifying child under the age of 17.

Qualifying child

The conference agreement follows the House bill and the Senate amendment. The conference agreement includes a requirement that the taxpayer include the name and taxpayer identification number (TIN) for each qualifying child. The conference agreement also extends the math and clerical error rule to the child tax credit.

Savings requirement

The conference agreement does not include the Senate amendment.

Reduction for dependent care credit

The conference agreement does not include the House bill provision.

Phaseout

The conference agreement follows the House bill and the Senate amendment with one modification. The modification is to increase the phaseout rate to $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. The threshold amounts are unchanged from both the House bill and the Senate amendment.

Maximum allowable child credit

In general, in the case of a taxpayer with qualifying children, the amount of the child credit equals $500 times the number of qualifying children.

In the case of a taxpayer with one or two qualifying children, a portion of the child credit may be treated as a supplemental child credit amount. This amount equals the excess of (1) $500 times the number of qualifying children up to the excess of the taxpayer's income tax liability (net of applicable credits other than the earned income credit) over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit) over (2) the sum of the taxpayer's regular income tax liability (net of applicable credits other than the earned income credit) and the employee share of FICA (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by any earned income credit amount. In no case will the total amount of the allowable child credit exceed the amount that would result from its calculation as a nonrefundable personal credit.

In the case of a taxpayer with three or more qualifying children, the maximum amount of the child credit for each taxable year cannot exceed the greater of: (1) the excess of the taxpayer's regular tax liability (net of applicable credits other than the earned income credit) over the taxpayer's tentative minimum tax liability (determined without regard to the alternative minimum foreign tax credit), or (2) an amount equal to the excess of the sum of the taxpayer's regular income tax liability (net of applicable credits other than the earned income credit) and the employee share of FICA (and one-half of the taxpayer's SECA tax liability, if applicable) reduced by the earned income credit. To the extent that the amount determined under (1) is greater than the amount determined under (2), the difference is treated as a supplemental child credit amount.

The conferees anticipate that the Secretary of the Treasury will determine whether a simplified method of calculating the child credit, consistent with the formula described above, can be achieved.

Refundable child credit amount

In the case of a taxpayer with three or more qualifying children, if the amount of the allowable child credit as computed under the computation described immediately above exceeds the taxpayer's regular tax liability before the computation, then the excess is a refundable tax credit.

IRS notice and withholding

The conference agreement does not include the House bill provision.

Effective date

Generally, the child tax credit is effective for taxable years beginning after December 31, 1997.

B. Expand Definition of High-Risk Individuals with Respect to Tax-Exempt State-Sponsored Organizations Providing Health Coverage (sec. 101(b) of the House bill)

Present Law

Present law provides tax-exempt status to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied.[1] The organization may provide coverage for medical care either by issuing insurance itself or by entering into an arrangement with a health maintenance organization ("HMO").

High-risk individuals eligible to receive medical care coverage from the organization must be residents of the State who, due to a pre-existing medical condition, are unable to obtain health coverage for such condition through insurance or an HMO, or are able to acquire such coverage only at a rate that is substantially higher than the rate charged for such coverage by the organization. The State must determine the composition of membership in the organization. For example, a State could mandate that all organizations that are subject to insurance regulation by the State must be members of the organization.

Present law further requires the State or members of the organization to fund the liabilities of the organization to the extent that premiums charged to eligible individuals are insufficient to cover such liabilities. Finally, no part of the net earnings of the organization can inure to the benefit of any private shareholder or individual.

House Bill

The House bill expands the definition of high-risk individuals to include a child of an individual who meets the present-law defi-

[1] No inference is intended as to the tax treatment of other types of State-sponsored organizations.

nition of a high-risk individual, subject to certain requirements. The requirements are: (1) the taxpayer is allowed a deduction for a personal exemption for the child for the taxable year; (2) the child has not attained the age of 17 as of the close of the calendar year in which the taxable year of the taxpayer begins; and (3) the child is a son or daughter or the taxpayer (or a dependent of either), a stepson or stepdaughter of the taxpayer, or an eligible foster child of the taxpayer.

Effective date.—Taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to further expand the definition of high-risk individuals to include the spouse of an individual who meets the present-law definition of a high-risk individual.

C. Indexing of the Dependent Care Credit; Phase Out for High-Income Taxpayers (sec. 102 of the House bill)

Present Law

A nonrefundable credit against income tax liability is available for up to 30 percent of a limited dollar amount of employment-related child and dependent care expenses. The credit may be claimed by an individual who maintains a household that includes one or more qualifying individuals. A qualifying individual is a dependent of the taxpayer who is under the age of 13, a physically or mentally incapacitated dependent, or a physically or mentally incapacitated spouse.

Employment-related expenses are expenses for household services and the care of a qualifying individual, if incurred to enable the taxpayer to be gainfully employed. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual, and $4,800 if there are two or more qualifying individuals.

The 30-percent credit rate is reduced by one percentage point for each $2,000 (or fraction thereof) of adjusted gross income ("AGI") above $10,000. A married couple's combined AGI is used for purposes of this computation. Individuals with more than $28,000 of AGI are entitled to a credit equal to 20 percent of allowable employment-related expenses.

House Bill

Dollar limits

Under the House bill, the dollar limits on eligible employment-related expenses ($2,400 if there is one qualifying individual and $4,800 if there are two or more qualifying individuals) are indexed for inflation.

Phaseout

For taxpayers with modified AGI in excess of certain thresholds, the sum of the otherwise allowable child credit and the otherwise allowable dependent care credit is phased out. The phaseout rate is $25 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold. The reduction is applied first to the child credit and then to the dependent care credit. For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation. (See above the description of the phaseout in the child tax credit.)

Effective date

The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

D. Tax Credit for Employer Expenses for Child Care Facilities (sec. 103 of the Senate amendment)

Present Law

Ordinary and necessary business expenses are deductible by an employer.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a tax credit equal to 50 percent of an employers' qualified child care expenses for the taxable year. The maximum credit allowable cannot exceed $150,000 per year.

Qualified child care expenses are any amounts paid or incurred: (1) to acquire, construct, rehabilitate or expand property which is to be used as part of a qualified child care facility, with respect to which a deduction for depreciation is allowable, and which is not part of the principal residence of the taxpayer or an employee of the taxpayer; (2) for the operating costs of a qualified child care facility; (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer; (4) under a contract to provide child care resource and referral services to employees of the taxpayer; or (5) for the costs of seeking accreditation for a child care facility. A qualified child care facility is a facility the principal use of which is to provide child care assistance and which meets the requirements of all applicable laws and regulations of the State and local government in which it is located. A facility is not a qualified child care facility unless enrollment in the facility is open to employees of the taxpayer during the year, the facility is not the principal trade or business of the taxpayer (unless at least 30 percent of the enrolled are dependents of employees of the taxpayer) and the use of (or eligibility to use) the facility does not discriminate in favor of highly compensated employees.

A recapture of the credit applies if the facility ceases to operate as a qualified child care facility or the facility is disposed of.

No deduction or credit is allowed under any other provision with respect to the amount of credit determined under this provision. The taxpayer's basis in property is reduced by the amount of credit determined with respect to such property.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1997, but before January 1, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment.

E. Expansion of Coordinated Enforcement Efforts Between the Internal Revenue Service and the Health and Human Services Office of Child Support Enforcement (sec. 104 of the Senate amendment)

Present Law

The Internal Revenue Service ("IRS") and various Federal departments and agencies have information sharing agreements. The Secretary of Health and Human Services ("HHS") has been directed to create and maintain various data bases which may be used by the IRS to collect unpaid child support amounts, to administer the earned income credit and to verify a claim with respect to employment on a tax return.

House Bill

No provision.

Senate Amendment

The Senate amendment gives the IRS expanded access to information in the National Directory of New Hires to verify any information which is required on a tax return. It also gives the IRS access to the names and social security numbers of custodial parents in the Federal Case Registry of Child Support Orders. This information is made available to administer the Internal Revenue Code provisions which grant tax benefits based on the support and residence of dependent children.

Effective date.—The provision is effective on October 1, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

F. Penalty-Free Withdrawals From IRAs for Adoption Expenses (sec. 105 of the Senate amendment)

Present Law

Under present law, amounts held in an individual retirement arrangement ("IRA") are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). 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 or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, or is used to purchase health insurance of an unemployed individual.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the 10-percent early withdrawal tax does not apply to distributions from IRAs that are not in excess of $2,000 if the taxpayer uses the amounts to pay qualified adoption expenses.

The penalty-free withdrawal is available for "qualified adoption expenses," meaning reasonable and necessary adoption fees, court costs, attorney fees, and other expenses which are directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer. Qualified adoption expenses do not include expenses (1) incurred in violation of State or Federal law, (2) incurred in carrying out any surrogate parenting arrangement, (3) incurred in connection with the adoption of a child of a spouse, or (4) which are reimbursed under an employer program or otherwise.

Effective date.—The provision is effective for distributions after December 31, 1996.

Conference Agreement

The conference agreement does not include the Senate amendment.

II. EDUCATION TAX INCENTIVES

A. Tax Benefits Relating to Education Expenses

1. HOPE tax credit and Lifetime Learning tax credit for higher education tuition expenses (sec. 201 of the House bill and the Senate amendment)

Present Law

Deductibility of education expenses

Taxpayers generally may not deduct education and training expenses. However, a deduction for education expenses generally is allowed under section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162–5). However, education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above-described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed 2 percent of the taxpayer's adjusted gross income (AGI).

Exclusion for employer-provided educational assistance

A special rule allows an employee to exclude from gross income for income tax purposes and from wages for employment tax purposes up to $5,250 annually paid by his or her employer for educational assistance (sec. 127). In order for the exclusion to apply, certain requirements must be satisfied, including a requirement that not more than 5 percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more than 5-percent owners of the employer and the spouses or dependents of such more than 5-percent owners. This special rule for employer-provided educational assistance expired with respect to courses beginning after June 30, 1997 (and does not apply to graduate level courses beginning after June 30, 1996).

For purposes of the special exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees, and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include tools or supplies which may be retained by the employee after completion of a course or meals, lodging, or transportation. The exclusion does not apply to any education involving sports, games, or hobbies.

In the absence of the special exclusion, employer-provided educational assistance is excludable from gross income and wages as a working condition fringe benefit (sec. 132(d)) only to the extent the education expenses would be deductible under section 162.

Exclusion for interest earned on savings bonds

Another special rule (sec. 135) provides that interest earned on a qualified U.S. Series EE savings bond issued after 1989 is excludable from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[2] "Qualified higher education expenses" include tuition and fees (but not room and board expenses) required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at certain colleges, universities, or vocational schools. The exclusion provided by section 135 is phased out for certain higher-income taxpayers, determined by the taxpayer's modified AGI during the year the bond is redeemed. For 1996, the exclusion was phased out for taxpayers with modified AGI between $49,450 and $64,450 ($74,200 and $104,200 for joint returns). To prevent taxpayers from effectively avoiding the income phaseout limitation through issuance of bonds directly in the child's name, section 135(c)(1)(B) provides that the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

Qualified scholarships

Section 117 excludes from gross income amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. There is, however, no dollar limitation for the section 117 exclusion, provided that the scholarship funds are used to pay for tuition and required fees. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for education below the graduate level provided to employees (and their spouses and dependents) of certain educational organizations.[3] Section 117(c) specifically provides that the exclusion for qualified scholarships and qualified tuition reductions does not apply to any

[2] If the aggregate redemption amount (i.e., principal plus interest) of all Series EE bonds redeemed by the taxpayer during the taxable year exceeds the qualified education expenses incurred, then the excludable portion of interest income is based on the ratio that the education expenses bears to the aggregate redemption amount (sec. 135(b)).

[3] A special rule provides that qualified tuition reductions under section 117(d) may be provided for graduate-level courses in cases of graduate students who are engaged in teaching or research activities for the educational organization (sec. 117(d)(5)).

amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

Student loan forgiveness

In the case of an individual, section 108(f) provides that gross income subject to Federal income tax does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers (e.g., providing health care services to a nonprofit organization). Student loans eligible for this special rule must be made to an individual to assist the individual in attending an education institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses (in contrast to tax-free scholarships under section 117, which are limited to tuition and required fees). In addition, the loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation. Thus, loans made with private, nongovernmental funds are not qualifying student loans for purposes of the section 108(f) exclusion. As with section 117, there is no dollar limitation for the section 108(f) exclusion.

Qualified State prepaid tuition programs

Section 529 (enacted as part of the Small Business Job Protection Act of 1996) provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. "Qualified higher education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). Qualified higher education expenses do not include room and board expenses. Section 529 also provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent receives a refund) will be included in the contributor's gross income to the extent such amounts exceed contributions made by that person.[4]

House Bill

In general

Individual taxpayers are allowed to claim a non-refundable HOPE credit against Federal income taxes up to $1,500 per student per year for 50 percent of qualified tuition and related expenses (but not room and board expenses) paid for the first two years of the student's post-secondary education in a degree or certificate program. The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent. The HOPE credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education. Beginning in 1998, the maximum credit amount of $1,500 will be indexed for inflation, rounded down to the closest multiple of $50.[5]

The HOPE credit amount that a taxpayer may otherwise claim is phased out ratably for taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions). The income phase-out ranges will be indexed for inflation occurring after the year 1999, rounded down to the closest multiple of $5,000. The first taxable year for which the inflation adjustment could be made to increase the income phase-out ranges will be 2001.

The HOPE credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition expenses paid with the proceeds of a loan generally are eligible for the HOPE credit (rather than repayment of the loan itself).[6]

Dependent students

A taxpayer may claim the HOPE credit with respect to an eligible student who is not the taxpayer or the taxpayer's spouse (e.g., in cases where the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by the parent or other taxpayer, the eligible student him- or herself is *not* entitled to claim a HOPE credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a

[4] Specifically, section 529(c)(3)(A) provides that any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the same manner as provided under present-law section 72 to the extent not excluded from gross income under any other provision of the Code.

[5] The HOPE credit may not be claimed against a taxpayer's alternative minimum tax (AMT) liability.

[6] The Treasury Department is granted authority to issue regulations providing that the HOPE credit will be recaptured in cases where the student or taxpayer receives a refund of tuition and related expenses with respect to which a credit was claimed in a prior year.

student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

Election of HOPE credit or proposed deduction for qualified higher education expenses

For each taxable year, a taxpayer may elect with respect to an eligible student *either* the HOPE credit *or* the proposed deduction for qualified higher education expenses (described below). Thus, for example, if a parent claims a child as a dependent for a taxable year, then all qualified tuition expenses paid by *both* the parent and child are deemed paid by the parent, and the parent may claim the HOPE credit (assuming that the AGI phaseout does not apply) on the parent's return. As an alternative, the parent may elect for that taxable year the deduction for qualified higher education expenses with respect to the dependent child (as described below).[7] On the other hand, if a child is *not* claimed as a dependent by the parent (or by any other taxpayer) for the taxable year, then the child him- or herself has the option of electing either the HOPE credit or deduction for qualified higher education expenses paid during that year.

Qualified tuition and related expenses

The HOPE credit is available for "qualified tuition and related expenses," meaning tuition, fees, and books required for the enrollment or attendance of an eligible student at an eligible educational institution. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are not included. The expenses of education involving sports, games, or hobbies are not qualified tuition expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year. No reduction of qualified tuition and related expenses is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). Under the provision, a HOPE credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.[8]

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[7] For any taxable year, a taxpayer may claim the HOPE credit for qualified tuition and related expenses paid with respect to one student and also claim the proposed deduction (described below) for higher education expenses paid with respect to one or more other students. If the HOPE credit is claimed with respect to one student for one or two taxable years, then the proposed deduction for higher education expenses may be available with respect to that student for subsequent taxable years.

[8] In addition, the bill amends present-law section 135 to provide that the amount of qualified higher education expenses taken into account for purposes of that section is reduced by the

Continued

Eligible students

An eligible student for purposes of the HOPE credit is an individual who is enrolled in a degree, certificate, or other program (including a program of study abroad approved for credit by the institution at which such student is enrolled) leading to a recognized educational credential at an eligible educational institution. The student must pursue a course of study on at least a half-time basis. (In other words, for at least one academic period which begins during the taxable year, the student must carry at least one-half the normal full-time work load for the course of study the student is pursuing.) An eligible student may not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institutions

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Regulations

The Secretary of the Treasury (in consultation with the Secretary of Education) is granted authority to issue regulations to implement the provision. The Secretary of the Treasury will have authority to issue regulations providing appropriate rules for recordkeeping and information reporting. These regulations may address the information reports that eligible educational institutions will be required to file to assist students and the IRS in calculating the amount of the HOPE credit potentially available.

Effective date

The provision is effective for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

Senate Amendment

The Senate amendment is the same as the House bill, except: (1) the credit rate is 75 percent (rather than 50 percent) for students attending two-year community colleges and vocational schools;[9] (2) an eligible student must have earned a high-school diploma (or equivalent degree) prior to attending any post-secondary classes with respect to which the HOPE credit is claimed, with the exception of students who did not receive a high-school degree by

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amount of such expenses taken into account in determining the HOPE credit claimed by any taxpayer with respect to the student for the taxable year.

[9] Thus, under the Senate amendment, students attending two-year community colleges or vocational schools may be eligible for the $1,500 maximum HOPE credit if they incur $2,000 of qualified tuition and related expenses. In contrast, students attending other institutions (e.g., four-year colleges) may be eligible for the $1,500 maximum HOPE credit if they incur $3,000 of qualified tuition and related expenses.

reason of enrollment in an early admission program at a post-secondary institution; and (3) for a taxable year, a taxpayer may elect with respect to an eligible student either the HOPE credit or the proposed exclusion from gross income for certain distributions from a qualified tuition program or education IRA provided for by the Senate amendment.

Conference Agreement

In general

The conference agreement follows the House bill, except: (1) the HOPE credit rate is 100 percent on the first $1,000 of qualified tuition and fees, and 50 percent on the next $1,000 of qualified tuition and fees;[10] (2) the HOPE credit is available only for tuition and fees required for the enrollment or attendance of an eligible student at an eligible institution, and is *not* available for expenses incurred to purchase books; and (3) for a taxable year, a taxpayer may elect with respect to an eligible student the HOPE credit, the 20-percent "Lifetime Learning" credit (as described below), or the exclusion from gross income for certain distributions from an education IRA (as provided by the conference agreement).

Lifetime Learning credit for qualified tuition and fees

Allowance of credit.—The conference agreement provides that individual taxpayers are allowed to claim a nonrefundable "Lifetime Learning" credit against Federal income taxes equal to 20 percent of qualified tuition and fees incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to $5,000 of qualified tuition and fees per taxpayer return will be eligible for the 20-percent Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return will be eligible for the 20-percent Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family.

The Lifetime Learning credit is phased out ratably over the same phaseout range that applies for purposes of the HOPE credit—i.e., taxpayers with modified AGI between $40,000 and $50,000

[10] Thus, an eligible student who incurs $1,000 of qualified tuition and fees is eligible (subject to the AGI phaseout) for a $1,000 HOPE credit; and if such a student incurs $2,000 of qualified tuition and fees, then he or she is eligible for a $1,500 HOPE credit.

The maximum HOPE credit amount will be indexed for inflation occurring after the year 2000, by increasing the cap on qualified tuition and fees subject to the 100-percent credit rate and the cap on such tuition and fees subject to the 50-percent credit rate (both caps rounded down to the closest multiple of $100). The first taxable year for which the inflation adjustment could be made to increase the cap on qualified tuition and fees will be 2002. In addition, under the conference agreement, the income phase-out ranges for the HOPE credit will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of $1,000. The first taxable year for which the inflation adjustment could be made to increase the income phase-out ranges will be 2002.

($80,000 and $100,000 for joint returns). The income phase-out ranges will be indexed for inflation occurring after the year 2000, rounded down to the closest multiple of $1,000. The first taxable year for which the inflation adjustment could be made to increase the income phase-out ranges will be 2002.

The Lifetime Learning credit is available in the taxable year the expenses are paid, subject to the requirement that the education commence or continue during that year or during the first three months of the next year. Qualified tuition and fees paid with the proceeds of a loan generally are eligible for the Lifetime Learning credit (rather than repayment of the loan itself).

Dependent students.—As with the HOPE credit, a taxpayer may claim the Lifetime Learning credit with respect to a student who is not the taxpayer or the taxpayer's spouse (e.g., in cases where the student is the taxpayer's child) only if the taxpayer claims the student as a dependent for the taxable year for which the credit is claimed. If a student is claimed as a dependent by the parent or other taxpayer, the student him- or herself is *not* entitled to claim the Lifetime Learning credit for that taxable year on the student's own tax return. If a parent (or other taxpayer) claims a student as a dependent, any qualified tuition and related expenses paid by the student are treated as paid by the parent (or other taxpayer) for purposes of the provision.

Election of Lifetime Learning credit, HOPE credit, or exclusion from gross income for certain distributions from education IRAs.—A taxpayer may claim the Lifetime Learning credit for a taxable year with respect to one or more students, even though the taxpayer also claims a HOPE credit (or claims an exclusion from gross income for certain distributions from qualified State tuition programs or education IRAs) for that same taxable year with respect to *other* students. If, for a taxable year, a taxpayer claims a HOPE credit with respect to a student (or claims an exclusion for certain distributions from an education IRA with respect to a student), then the Lifetime Learning credit will *not* be available with respect to that same student for that year (although the Lifetime Learning credit may be available with respect to that same student for other taxable years).

Qualified tuition and fees.—The Lifetime Learning credit is available for "qualified tuition and fees," meaning tuition and fees required for the enrollment or attendance of the eligible student at an eligible institution. Charges and fees associated with meals, lodging, student activities, athletics, insurance, transportation, and similar personal, living or family expenses are not included. The 20-percent credit is not available for expenses incurred to purchase books. The expenses of education involving sports, games, or hobbies are not qualified tuition expenses unless this education is part of the student's degree program.

In contrast to the HOPE credit, qualified tuition and fees for purposes of the Lifetime Learning credit include tuition and fees incurred with respect to undergraduate or graduate-level (and professional degree) courses.[11] In addition to allowing a credit for the

[11] The HOPE credit is available only with respect to the first two years of a student's undergraduate education.

tuition and fees of a student who attends classes on at least a half-time basis as part of a degree or certificate program, the Lifetime Learning credit also is available with respect to any course of instruction at an eligible educational institution (whether enrolled in by the student on a full-time, half-time, or less than half-time basis) to acquire or improve job skills of the student.

Qualified tuition and fees are defined in the same manner as under the HOPE credit provisions. Thus, qualified tuition and fees generally include only out-of-pocket expenses. Qualified tuition and fees do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and fees are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year (such as employer-provided educational assistance excludable under section 127). No reduction of qualified tuition and fees is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). Under the provision, a Lifetime Learning credit is not allowed with respect to any education expense for which a deduction is claimed under section 162 or any other section of the Code.[12]

Eligible educational institutions.—Eligible educational institutions are (as with the HOPE credit) defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Regulations.—The Secretary of the Treasury (in consultation with the Secretary of Education) is granted authority to issue regulations to implement the provision. The Secretary of the Treasury will have authority to issue regulations providing appropriate rules for recordkeeping and information reporting. These regulations may address the information reports that eligible educational institutions will be required to file to assist students and the IRS in calculating the amount of the Lifetime Learning credit potentially available.

Effective date.—The provision is effective for expenses paid after June 30, 1998, for education furnished in academic periods beginning after such date.

[12] In addition, the conference agreement amends present-law section 135 to provide that the amount of qualified higher education expenses taken into account for purposes of that section is reduced by the amount of such expenses taken into account in determining the Lifetime Learning credit claimed by any taxpayer with respect to the student for the taxable year.

2. Tax treatment of qualified State tuition programs and education IRAs; exclusion for certain distributions from education IRAs used to pay qualified higher education expenses (secs. 202 (a), (b), and (d) and 211–212 of the House bill and secs. 211–213 of the Senate amendment)

Present Law

Deductibility of education expenses

Taxpayers generally may not deduct education and training expenses. However, a deduction for education expenses generally is allowed under section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162–5). However, education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above-described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed 2 percent of the taxpayer's adjusted gross income (AGI).

Exclusion for employer-provided educational assistance

A special rule allows an employee to exclude from gross income for income tax purposes and from wages for employment tax purposes up to $5,250 annually paid by his or her employer for educational assistance (sec. 127). In order for the exclusion to apply, certain requirements must be satisfied, including a requirement that not more than 5 percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more than 5-percent owners of the employer and the spouses or dependents of such more than 5-percent owners. This special rule for employer-provided educational assistance expired with respect to courses beginning after June 30, 1997 (and does not apply to graduate level courses beginning after June 30, 1996).

For purposes of the special exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees, and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include tools or supplies which may be retained by the employee after completion of a course or meals, lodging, or transportation. The exclusion does not apply to any education involving sports, games, or hobbies.

In the absence of the special exclusion, employer-provided educational assistance is excludable from gross income and wages as a working condition fringe benefit (sec. 132(d)) only to the extent the education expenses would be deductible under section 162.

Exclusion for interest earned on savings bonds

Another special rule (sec. 135) provides that interest earned on a qualified U.S. Series EE savings bond issued after 1989 is excludable from gross income if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during the taxable year.[13] "Qualified higher education expenses" include tuition and fees (but not room and board expenses) required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer at certain colleges, universities, or vocational schools. The exclusion provided by section 135 is phased out for certain higher-income taxpayers, determined by the taxpayer's modified AGI during the year the bond is redeemed. For 1996, the exclusion was phased out for taxpayers with modified AGI between $49,450 and $64,450 ($74,200 and $104,200 for joint returns). To prevent taxpayers from effectively avoiding the income phaseout limitation through issuance of bonds directly in the child's name, section 135(c)(1)(B) provides that the interest exclusion is available only with respect to U.S. Series EE savings bonds issued to taxpayers who are at least 24 years old.

Qualified scholarships

Section 117 excludes from gross income amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. There is, however, no dollar limitation for the section 117 exclusion, provided that the scholarship funds are used to pay for tuition and required fees. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for education below the graduate level provided to employees (and their spouses and dependents) of certain educational organizations.[14] Section 117(c) specifically provides that the exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

Student loan forgiveness

In the case of an individual, section 108(f) provides that gross income subject to Federal income tax does not include any amount from the forgiveness (in whole or in part) of certain student loans,

[13] If the aggregate redemption amount (i.e., principal plus interest) of all Series EE bonds redeemed by the taxpayer during the taxable year exceeds the qualified education expenses incurred, then the excludable portion of interest income is based on the ratio that the education expenses bears to the aggregate redemption amount (sec. 135(b)).

[14] A special rule provides that qualified tuition reductions under section 117(d) may be provided for graduate-level courses in cases of graduate students who are engaged in teaching or research activities for the educational organization (sec. 117(d)(5)).

provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers (e.g., providing health care services to a nonprofit organization). Student loans eligible for this special rule must be made to an individual to assist the individual in attending an education institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses (in contrast to tax-free scholarships under section 117, which are limited to tuition and required fees). In addition, the loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation. Thus, loans made with private, nongovernmental funds are not qualifying student loans for purposes of the section 108(f) exclusion. As with section 117, there is no dollar limitation for the section 108(f) exclusion.

Qualified State prepaid tuition programs

Section 529 (enacted as part of the Small Business Job Protection Act of 1996) provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. "Qualified higher education expenses" are defined as tuition, fees, books, supplies, and equipment required for the enrollment or attendance at a college or university (or certain vocational schools). Qualified higher education expenses do not include room and board expenses. Section 529 also provides that no amount shall be included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) will be included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor (e.g., when a parent receives a refund) will be included in the contributor's gross income to the extent such amounts exceed contributions made by that person.[15]

[15] Specifically, section 529(c)(3)(A) provides that any distribution under a qualified State tuition program shall be includible in the gross income of the distributee in the same manner as

Estate and gift tax rules

In general, a taxpayer may exclude $10,000 of gifts made by an individual ($20,000 in the case of a married couple that elects to split their gifts) to any one donee during a calendar year (sec. 2503(b)). This annual exclusion does not apply to gifts of future interests, and thus may not be applicable to contributions made to a State tuition program.

Contributions made to a qualified State tuition program are treated as incomplete gifts for Federal gift tax purposes (sec. 529(c)(2)). Thus, any Federal gift tax consequences are determined at the time that a distribution is made from an account under the program. The waiver (or payment) of qualified higher education expenses of a designated beneficiary by (or to) an educational institution under a qualified State tuition program is treated as a qualified transfer for purposes of present-law section 2503(e). Amounts contributed to a qualified State tuition program (and earnings thereon) are includible in the contributor's estate for Federal estate tax purposes in the event that the contributor dies before such amounts are distributed under the program (sec. 529(c)(4)).

Individual retirement arrangements ("IRAs")

An individual may make deductible contributions to an individual retirement arrangement ("IRA") for each taxable year up to the lesser of $2,000 or the amount of the individual's compensation for the year if the individual is not an active participant in an employer-sponsored qualified retirement plan (and, if married, the individual's spouse also is not an active participant). Contributions may be made to an IRA for a taxable year up to April 15th of the following year. An individual who makes excess contributions to an IRA, i.e., contributions in excess of $2,000, is subject to an excise tax on such excess contributions unless they are distributed from the IRA before the due date for filing the individual's tax return for the year (including extensions). If the individual (or his or her spouse, if married) is an active participant, the $2,000 limit is phased out between $40,000 and $50,000 of adjusted gross income ("AGI") for married couples and between $25,000 and $35,000 of AGI for single individuals.

Present law permits individuals to make nondeductible contributions (up to $2,000 per year) to an IRA to the extent an individual is not permitted to (or does not) make deductible contributions. Earnings on such contributions are includible in gross income when withdrawn.

An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA. Amounts withdrawn from an IRA are includible in gross income (except to the extent of nondeductible contributions). In addition, a 10-percent additional tax generally applies to distributions from IRAs made before age 59½, unless the distribution is made (1) on account of death or disability, (2) in the form of annuity payments, (3) for medical expenses of the individual and his or her spouse and dependents that

provided under present-law section 72 to the extent not excluded from gross income under any other provision of the Code.

exceed 7.5 percent of AGI, or (4) for medical insurance of the individual and his or her spouse and dependents (without regard to the 7.5 percent of AGI floor) if the individual has received unemployment compensation for at least 12 weeks, and the withdrawal is made in the year such unemployment compensation is received or the following year.

House Bill

In general

Individual taxpayers are allowed a deduction of up to $10,000 per student per year for qualified higher education expenses paid by the taxpayer during the taxable year for education furnished to the taxpayer, the taxpayer's spouse, or a dependent. The deduction is allowed regardless of whether the taxpayer otherwise itemizes deductions or claims the standard deduction.[16] A deduction is not allowed under the House bill with respect to an otherwise eligible student if the HOPE credit (as described previously) is claimed with respect to that student for the same taxable year.[17]

The deduction is allowed only to the extent that the taxpayer is required to include in gross income for the taxable year amounts distributed from a "qualified tuition program" or "education investment account." In other words, amounts distributed from a qualified tuition program or education investment account that are includible in the taxpayer's gross income (i.e., earnings) and that are used to pay for qualified higher education expenses during the taxable year will be deductible under the provision (subject to a $10,000 annual limit per student). Amounts distributed from qualified tuition programs or education investment accounts generally will be includible in the gross income of the distributee in the same manner as provided under present-law section 72 (to the extent not excluded under any other section, such as section 117).

Under the House bill, the deduction is limited to $10,000 per student for each taxable year. Aggregate deductions under the bill with respect to any one student may not exceed $40,000 for all taxable years. A deduction is not permitted with respect to a student after he or she completes the equivalent of the first four years of post-secondary education at an eligible educational institution.

Dependent students

If a parent (or other taxpayer) claims a student as a dependent for a taxable year, then only the parent (or other taxpayer)—and not the student—may claim the deduction for qualified higher education expenses for that taxable year. In such a case where the parent claims the proposed deduction for qualified higher education expenses, amounts includible in gross income by reason of a distribution from a qualified tuition program or education investment account will be includible in the parent's (or other taxpayer's) gross

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[16] The deduction will be claimed after a taxpayer computes adjusted gross income (AGI). The deduction is not a preference item for alternative minimum tax (AMT) purposes.

[17] If a HOPE credit was claimed with respect to a student for an earlier taxable year (i.e., the student's first or second year of post-secondary education), the deduction provided for by the House bill may be claimed with respect to that student for a subsequent taxable year.

income for that taxable year.[18] If a parent (or other taxpayer) claims a student as a dependent for a taxable year, then all qualified higher education expenses paid that year by both the parent (or other taxpayer) and the student are deemed to be paid by the parent (or other taxpayer). If the student is not claimed as a dependent by another taxpayer, then only the student him- or herself may claim the deduction provided for by the bill (or, as an alternative, the HOPE credit described above) on the student's own tax return for the taxable year.[19]

Qualified higher education expenses

Under the House bill, the term "qualified higher education expenses" means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible education institution, as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965). Qualified higher education expenses do not include expenses for any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree.

Qualified higher education expenses generally include only out-of-pocket expenses. Qualified higher education expenses do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified higher education expenses are reduced by any scholarship or fellowship grants excludable from gross income under present-law section 117 and any other tax-free educational benefits received by the student during the taxable year. In addition, no deduction is allowed under the bill for expenses paid with amounts that are excludible under

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[18] Such an income inclusion is required on the parent's return only if the parent both claims the student as a dependent and elects the deduction provided for by the bill. In contrast, if the parent claims the student as a dependent but elects the HOPE credit, then, if there is any distribution from a qualified tuition program or education investment account during that year, the earnings portion of such distributions will be includible in the student's (or other distributee's) gross income, as provided for by present-law section 529(c)(3).

[19] For example, assume an education investment account (or qualified tuition program account) has a balance of $20,000, of which $12,000 represents contributions of principal and $8,000 represents accumulated earnings. If the student has expenses of $10,000 consisting of $7,000 tuition and related expenses and $3,000 in room and board, a distribution of $10,000 from such account to pay these expenses will, under present-law section 72, be deemed to consist of the pro-rata share of principal and accumulated earnings in the account—in this case, $6,000 in principal and $4,000 in accumulated earnings. If the parent claims the student as a dependent and elects the proposed deduction for qualified higher education expenses, the parent will include the $4,000 of accumulated earnings in the parent's gross income and then is allowed to claim an offsetting deduction for the same $4,000, thus resulting in no tax liability for the $4,000 in earnings. Under no circumstances will the principal portion of any distribution from the account be includible in gross income, nor will a deduction be allowed under the bill for education expenses paid with such principal. Alternatively, the parent may elect to claim the HOPE credit (assuming that the AGI phaseout does not apply and the student is claimed as a dependent and has not yet completed the first two years of post-secondary education), and the $4,000 in accumulated earnings will be includible in the distributee's (i.e., the student's) gross income and an offsetting deduction will not be available. Additionally, the qualified expenses for purposes of the HOPE credit will not include room and board expenses, so only $7,000 in expenses will qualify for the HOPE credit. The 50-percent HOPE credit rate will then be applied to this amount, which indicates a credit amount of $3,500, but the credit that could be claimed will be limited to the statutory maximum of $1,500 per student. As a final alternative, if the parent does not claim the student as a dependent, then the student may elect to claim either the HOPE credit or the deduction as described above.

section 135. No reduction of qualified tuition expenses is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). If a student's education expenses for a taxable year are deducted under section 162 or any other section of the Code, then no deduction is available for such expenses under the bill.

Eligible students

To be eligible for the deduction provided for by the bill, a student must be at least a half-time student in a degree or certificate program at an eligible educational institution. For this purpose, a student is at least a half-time student if, during at least one academic period which begins during the taxable year, he or she is carrying at least one-half the normal full-time work load for the course of study the student is pursuing. A student will no longer be an eligible student once he or she has completed the equivalent of the first four years of post-secondary education at an eligible educational institution. An eligible student may not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institution

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible educational institutions. The institution must be eligible to participate in Department of Education student aid programs.

Qualified tuition programs and education investment accounts

Under the House bill, a "qualified tuition program" means any qualified State tuition program, generally as defined under present-law section 529, as well as any program established and maintained by one or more eligible educational institutions (which may be private institutions that are not State-owned) that satisfy the requirements under section 529 (other than present-law, State ownership rule). An "education investment account" means a trust which is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of the account holder and which satisfies certain other requirements.

Contributions to qualified tuition programs or education investment accounts may be made only in cash.[20] Such contributions may not be made after the designated beneficiary or account holder

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[20] The House bill allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under section 135 (as if the proceeds were used to pay qualified higher education expenses) if the proceeds from the redemption are contributed to a qualified tuition program or education investment account on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In such a case, the beneficiary's or account holder's basis in the bond proceeds contributed on his or her behalf to the qualified tuition program or education investment will be the contributor's basis in the bonds (i.e., the original purchase price paid by the contributor for such bonds).

The House bill also provides that funds from an education investment account are deemed to be distributed to pay qualified higher education expenses if the funds are used to purchase tuition credits from, or to make contributions to, a qualified tuition program for the benefit of the account holder.

reaches age 18. Any balance remaining in a qualified tuition program or education investment account must be distributed within 30 days after the earlier of the date that the beneficiary or account holder becomes 30 years old (or dies) or the date that the beneficiary or account holder completes the equivalent of the first four years of post-secondary education at one or more eligible institutions. Transfers or rollovers of credits or account balances from one account benefiting one beneficiary to another account benefiting another beneficiary will not be considered a distribution from a qualified tuition program or education investment account (nor will a change in the designated beneficiary or account holder) if the new beneficiary is a member of the family of the old beneficiary.[21] In the case of an education investment account or qualified tuition program maintained by one or more private educational institutions, contributions to an account established on behalf of a particular beneficiary (or to a program on behalf of a named beneficiary) may not exceed $5,000 per year, with an aggregate limit of $50,000 for contributions on behalf of that beneficiary for all years. The $50,000 aggregate contribution limit per beneficiary is applied by taking into account all amounts contributed to all education investment accounts for the beneficiary for the current taxable year and all prior taxable years, as well as all amounts contributed to all qualified tuition programs on behalf of such beneficiary for the current taxable year and all prior taxable years.[22]

Qualified tuition programs and education investment accounts (as separate legal entities) will be exempt from Federal income tax, other than taxes imposed under the present-law unrelated business income tax (UBIT) rules.[23]

Under the House bill, an additional tax of 10 percent will be imposed on distributions from qualified tuition programs or education investment account to the extent the distribution exceeds qualified higher education expenses paid by the taxpayer (and is not made on account of the death, disability, or scholarship received by the designated beneficiary or account holder).

Estate and gift tax treatment

For Federal estate and gift tax purposes, any contribution to a qualified tuition program or education investment account will be treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Thus, annual contributions—which cannot exceed $5,000 per year in the case of an education investment account or qualified tuition program maintained by one or more private education institutions—will be

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[21] For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

[22] To the extent contributions exceed the $50,000 aggregate limit, an excise tax penalty may be imposed on the contributor under present-law section 4973, unless the excess contributions (and any earnings thereon) are returned to the contributor before the due date for the return for the taxable year during which the excess contribution is made.

State-sponsored qualified tuition programs will continue to be governed by the rule contained in present-law section 529(b)(7) that such programs provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. State-sponsored qualified tuition programs will not be subject to a specific dollar cap under section 529 on annual (or aggregate) contributions that can be made under the program on behalf of a named beneficiary.

[23] An interest in a qualified tuition program is not treated as debt for purposes of the debt-financed property UBIT rules of section 514.

eligible for the present-law gift tax exclusion provided by Code section 2503(b) and also will be excludable for purposes of the generation-skipping transfer tax (provided that the contribution, when combined with any other contributions made by the donor to that same beneficiary, does not exceed the annual $10,000 gift-tax exclusion limit). Similar gift tax and generation-skipping tax treatment will apply to contributions of up to $10,000 per donor per beneficiary made to a State-sponsored qualified tuition program. Contributions to a qualified tuition program (either a State-sponsored program or one maintained by a private education institution) or to an education investment account will not, however, be eligible for the educational expense exclusion provided by Code section 2503(e). In no event will a distribution from a qualified tuition program or education investment account be treated as a taxable gift.

Transfers or rollovers of credits or account balances from an account benefiting one beneficiary to an account benefiting another beneficiary (or a change in the designated beneficiary) will not be treated as a taxable gift to the extent that the new beneficiary is: (1) a member of the family of the old beneficiary (as defined above), and (2) assigned to the same generation as the old beneficiary (within the meaning of Code section 2651). In all other cases, a transfer from one beneficiary to another beneficiary (or a change in the designated beneficiary) will be treated as a taxable gift from the old beneficiary to the new beneficiary to the extent it exceeds the $10,000 present-law gift tax exclusion. Thus, a transfer of an account from a brother to his sister will not be treated as a taxable gift, whereas a transfer from a father to his son will be treated as a taxable gift (to the extent it exceeds the $10,000 present-law gift tax exclusion).

For estate tax purposes, the value of any interest in a qualified tuition program or education investment account will be includible in the estate of the designated beneficiary. In no event will such interests be includible in the estate of the contributor.

Effective date

The deduction for qualified higher education expenses, and the expansion of the definition of qualified higher education expenses under section 529 to cover room and board expenses, are effective for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date. The provisions governing the tax-exempt status of qualified tuition plans and education investment accounts generally are effective after December 31, 1997. The gift tax provisions are effective for contributions (or transfers) made after the date of enactment, and the estate tax provisions are effective for decedents dying after June 8, 1997.

Senate Amendment

In general

Under the Senate amendment, amounts distributed from qualified tuition programs and certain education investment accounts (referred to as "education IRAs") are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of an eligible student incurred during the year the distribution is made.[24] In addition, distributions from education IRAs (but not qualified tuition programs) in taxable years beginning in 2001 or later will be excludable from gross income to the extent that the amounts distributed do not exceed certain qualified elementary and secondary education expenses. An exclusion is not allowed under the bill with respect to an otherwise eligible student if the HOPE credit (as described previously) is claimed with respect to that student for the taxable year the distribution is made.[25]

Distributions from a qualified tuition program or education IRA generally will be deemed to consist of distributions of principal (which, under all circumstances, are excludable from gross income) and earnings (which may be excludable from gross income under the Senate amendment) by applying the ratio that the aggregate amount of contributions to the program or account for the beneficiary bears to the total balance (or value) of the program or account for the beneficiary at the time the distribution is made.[26] If the qualified higher education expenses of the student for the year are at least equal to the total amount of the distribution (i.e., principal and earnings combined) from a qualified tuition program or education IRA, then the earnings in their entirety will be excludable from gross income. If, on the other hand, the qualified higher education expenses of the student for the year are less than the total amount of the distribution (i.e., principal and earnings combined) from a qualified tuition program or education IRA, then the qualified higher education expenses will be deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings will be excludable under the bill (i.e., a portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings will be includible in the gross income of the distributee.[27]

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[24] The exclusion will not be a preference item for alternative minimum tax (AMT) purposes.

[25] If a HOPE credit was claimed with respect to a student for an earlier taxable year (i.e., the student's first or second year of post-secondary education), the exclusion provided for by the bill may be claimed with respect to that student for a subsequent taxable year.

[26] Specifically, the Senate amendment provides as a general rule that distributions from a qualified tuition program or education IRA are includible in gross income to the extent allocable to income on the program or account and are not includible in gross income to the extent allocable to the investment (i.e., contributions) in the program or account. However, the Senate amendment further provides that, if the HOPE credit is not claimed with respect to the student for the taxable year, then a distribution from a qualified tuition program or education IRA will not be includible in gross income to the extent that the distribution does not exceed the qualified higher expenses of the student for the year. If a distribution consists of providing in-kind education benefits to the student which, if paid for by the student, would constitute payment of qualified higher education expenses, then no portion of such distribution will be includible in gross income.

At the time that a final distribution is made from a qualified tuition program or education IRA, the distribution will be deemed to include the full amount of any basis remaining with respect to the program or account.

[27] For example, if a $1,000 distribution from a qualified tuition program or education IRA consists of $600 of principal (i.e., contributions) and $400 of earnings, and if the student incurs $750 of qualified higher education expenses during the year, then $300 of the earnings will be excludable from gross income under the bill (i.e., an exclusion will be provided for the pro-rata portion of the earnings, based on the ratio that the $750 of qualified expenses bears to the $1,000 total distribution) and the remaining $100 of earnings will be includible in the distributee's gross income.

Eligible students

To be an eligible student, an individual must be at least a half-time student in a degree or certificate undergraduate or graduate program at an eligible educational institution. For this purpose, a student is at least a half-time student if he or she is carrying at least one-half the normal full-time work load for the course of study the student is pursuing. An eligible student may not have been convicted of a Federal or State felony consisting of the possession or distribution of a controlled substance.

Eligible educational institution

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Qualified education expenses

"Qualified higher education expenses" include tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible education institution, as well as room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses.

In addition, in taxable years beginning after December 31, 2000, the exclusion is available to the extent that distributions from an education IRA (but not a qualified tuition program) do not exceed "qualified elementary and secondary education expenses," meaning tuition, fees, tutoring, special needs services, books, supplies, equipment, transportation, and supplementary expenses (including homeschooling expenses if the requirements of State or local law are satisfied with respect to such homeschooling) required for the enrollment or attendance of a dependent of the taxpayer at a public, private, or sectarian elementary or secondary school (through grade 12).

Qualified higher education expenses (and qualified elementary and secondary education expenses) generally include only out-of-pocket expenses. Such qualified education expenses do not include expenses covered by educational assistance that is not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127. In addition, qualified education expenses do not include expenses paid with amounts that are excludible under section 135. No reduction of qualified education expenses is required for a gift, bequest, devise, or inheritance within the meaning of section 102(a). If education expenses for a taxable year are deducted under section 162 or any other section of the Code, then such expenses are not qualified education expenses under the Senate amendment.

Qualified tuition programs and education IRAs

Under the Senate amendment, a "qualified tuition program" means any qualified State-sponsored tuition program, defined under section 529 (as modified by the bill), as well as any program established and maintained by one or more eligible educational institutions (which could be private institutions) that satisfy the requirements under section 529 (other than present-law State ownership rule). An "education IRA" means a trust (or custodial account) which is created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses (and qualified elementary and secondary education expenses) of the account holder and which satisfies certain other requirements.

Contributions to qualified tuition programs or education IRAs may be made only in cash.[28] Such contributions may not be made after the designated beneficiary or account holder reaches age 18. Annual contributions to a qualified tuition program not maintained by a State (i.e., a qualified tuition program operated by one or more private schools) or to an education IRA are limited to $2,000 per beneficiary or account holder, plus the amount of any child credit (as provided for by the Senate amendment) that is allowed for the taxable year with respect to the beneficiary or account holder.[29] Thus, in the case of any child with respect to whom the maximum $500 child credit is allowed for the taxable year, the contribution limit with respect to such child for the year will be $2,500.[30] Trustees of qualified tuition programs not maintained by a State and trustees of education IRAs are prohibited from accepting contributions to any account on behalf of a beneficiary in excess of $2,500

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[28] The Senate amendment allows taxpayers to redeem U.S. Savings Bonds and be eligible for the exclusion under section 135 (as if the proceeds were used to pay qualified higher education expenses) if the proceeds from the redemption are contributed to a qualified tuition program or education IRA on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In such a case, the beneficiary's or account holder's basis in the bond proceeds contributed on his or her behalf to the qualified tuition program or education IRA will be the contributor's basis in the bonds (i.e., the original purchase price paid by the contributor for such bonds).

The Senate amendment also provides that funds from an education IRA are deemed to be distributed to pay qualified higher education expenses if the funds are used to make contributions to (or purchase tuition credits from) a qualified tuition program for the benefit of the account holder.

[29] State-sponsored qualified tuition programs will continue to be governed by the rule contained in present-law section 529(b)(7) that such programs provide adequate safeguards to prevent contributions on behalf of a designated beneficiary in excess of those necessary to provide for the qualified higher education expenses of the beneficiary. State-sponsored qualified tuition programs will not be subject to a specific dollar limit on annual contributions that can be made under the program on behalf of a designated beneficiary.

[30] The maximum contribution limit for the year is increased even if the child is younger than age 13—that is, even in cases where the parent is not required (under the provision described previously) but may elect to deposit an amount equal to the child credit into a qualified tuition program or education IRA on behalf of the child.

for any year (except in cases involving certain tax-free rollovers, as described below).[31]

If any balance remaining in an education IRA is not distributed by the time that the account holder becomes 30 years old, then the account will be deemed to be an IRA Plus account (as provided for by the bill and described below) established on behalf of the same account holder.[32] The Senate amendment allows (but does not require) tax-free transfers or rollovers of account balances from a qualified tuition program to an IRA Plus account when the beneficiary becomes 30 years old, provided that the funds from the qualified tuition program account are deposited in the IRA Plus account within 60 days after being distributed from the qualified tuition program.[33] In addition, the Senate amendment allows tax-free transfers or rollovers of credits or account balances from one qualified tuition program or education IRA account benefiting one beneficiary to another program or account benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.[34]

Qualified tuition programs and education IRAs (as separate legal entities) will be exempt from Federal income tax, other than taxes imposed under the present-law unrelated business income tax (UBIT) rules.[35]

Under the Senate amendment, an additional 10-percent penalty tax will be imposed on any distribution from a qualified tuition program not maintained by a State or from an education IRA to the extent that the distribution exceeds qualified higher education expenses (or, in the case of an education IRA, qualified elementary and secondary education expenses) incurred by the taxpayer (and is not made on account of the death, disability, or scholarship received by the designated beneficiary or account holder).[36]

Estate and gift tax treatment

Contributions to qualified tuition programs and education IRAs will not be considered taxable gifts for Federal gift tax purposes, and in no event will distributions from a qualified tuition programs or education IRAs be treated as taxable gifts.[37] For estate tax pur-

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[31] The annual $2,000 to $2,500 contribution limit is applied by taking into account all contributions made to any qualified tuition program not maintained by a State and any education IRA on behalf of a designated individual (but not any contributions made to State-sponsored qualified tuition programs). To the extent contributions exceed the annual contribution limit, an excise tax penalty may be imposed on the contributor under present-law section 4973, unless the excess contributions (and any earnings thereon) are returned to the contributor before the due date for the return for the taxable year during which the excess contribution is made.

[32] In such cases, the 5-year holding period applicable to IRA Plus accounts begins with the taxable year in which the education IRA is deemed to be an IRA Plus account.

[33] In the event of such a rollover, the 5-year holding period applicable to IRA Plus accounts begins with the taxable year in which the rollover occurs.

[34] For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

[35] An interest in a qualified tuition program is not treated as debt for purposes of the debt-financed property UBIT rules of section 514.

[36] Distributions from State-sponsored qualified tuition programs will *not* be subject to this 10-percent additional penalty tax, but will continue to be governed by the present-law section 529(b)(3) rule that the State-sponsored programs themselves are required to impose a "more than de minimis penalty" on any refund of earnings not used for qualified higher education expenses (other than in cases where the refund is made on account of death or disability of, or receipt of a scholarship by, the beneficiary).

[37] Contributions to only one State-sponsored qualified tuition program per beneficiary will be excluded from the gift tax by reason of the bill (although a contributor may also make contribu-

poses, the value of any interest in a qualified tuition program or education IRA will be includible in the estate of the designated beneficiary. In no event will such an interest be includible in the estate of the contributor.

Effective date

The provision applies to distributions made, and qualified higher education expenses paid, after December 31, 1997, for education furnished in academic periods beginning after such date. In addition, in the case of education IRAs, the provision applies to qualified elementary and secondary expenses paid in taxable years beginning after December 31, 2000. The provisions governing contributions to, and the tax-exempt status of, qualified tuition plans and education IRAs generally apply after December 31, 1997. The gift tax provisions are effective for contributions (or transfers) made after the date of enactment, and the estate tax provisions are effective for decedents dying after June 8, 1997.

Conference Agreement

Qualified State tuition programs

The conference agreement makes the following modifications to present-law section 529, which governs the tax treatment of qualified State tuition programs.

Room and board expenses.—The conference agreement expands the definition of "qualified higher education expenses" under section 529(e)(3) to include room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) for any period during which the student is at least a half-time student.

Eligible educational institution.—The conference agreement expands the definition of "eligible educational institution" for purposes of section 529 by defining such term by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Definition of "member of family".—The conference agreement expands the definition of the term "member of the family" for purposes of allowing tax-free transfers or rollovers of credits or account balances in qualified State tuition programs (and redesignations of named beneficiaries), so that the term means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters,

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tions excluded from the gift tax on behalf of *other* beneficiaries to the same State-sponsored program or any other State-sponsored program).

brothers, sisters, nephews and nieces, certain in-laws, etc.—and any spouse of such persons.[38]

Prohibition against investment direction.—The conference clarifies the present-law rule contained in section 529(b)(5) that qualified State tuition programs may not allow contributors or designated beneficiaries to direct the investment of contributions to the program (or earnings thereon) by specifically providing that contributors and beneficiaries may not "directly or indirectly" direct the investment of contributions to the program (or earnings thereon).

Interaction with HOPE credit and Lifetime Learning credit.—Under the conference agreement (as under present law), no amount will be includible in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to any contribution to or earnings on such a program until a distribution is made from the program, at which time the earnings portion of the distribution (whether made in cash or in-kind) will be includible in the gross income of the distributee. However, to the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and fees, the distributee (or another taxpayer claiming the distributee as a dependent) will be able to claim the HOPE credit or Lifetime Learning credit provided for by the conference agreement with respect to such tuition and fees (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phaseout for those credits does not apply).[39]

Effective date.—The modifications to section 529 generally are effective after December 31, 1997. The expansion of the term "qualified higher education expenses" to cover certain room and board expenses is effective as if included in the Small Business Job Protection Act of 1996 (enacted on August 20, 1996).

Education IRAs

The conference agreement generally follows the Senate amendment with respect to the treatment of education IRAs, with the following modifications.

Contribution limit.—Under the conference agreement, annual contributions to education IRAs are limited to $500 per beneficiary. This $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to

[38] The conference agreement also provides a special rule that, in the case of any contract issued prior to August 20, 1996 (i.e., the date of enactment of section 529), section 529(c)(3)(C) will be applied without regard to the requirement that a distribution be transferred to a member of the family or the requirement that a change in beneficiaries may be made only to a member of the family.

[39] In cases where in-kind benefits are provided to a beneficiary under a qualified State prepaid tuition program, present-law section 529(c)(3)(B) provides that the provision of such benefits is treated as a distribution to the beneficiary. Thus, to the extent such in-kind benefits, if paid for by the beneficiary, would constitute payment of qualified tuition and fees for purposes of the HOPE credit or Lifetime Learning credit, the beneficiary (or another taxpayer claiming the beneficiary as a dependent) may be able to claim the HOPE credit or Lifetime Learning credit with respect to payments that are deemed to be made by the beneficiary with respect to the in-kind benefit.

make contributions to an education IRA established on behalf of any other individual.[40]

Qualified expenses.—Education IRAs must be created exclusively for the purpose of paying qualified higher education expenses, meaning post-secondary tuition, fees, books, supplies, equipment, and certain room and board expenses, and not including elementary or secondary school expenses.

Expansion of exclusion for part-time students.—The conference agreement provides that distributions from an education IRA are excludable from gross income to the extent that the distribution does not exceed qualified higher education expenses incurred by the beneficiary during the year the distribution is made, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. However, room and board expenses (meaning the minimum room and board allowance applicable to the student as determined by the institution in calculating costs of attendance for Federal financial aid programs under sec. 472 of the Higher Education Act of 1965) are qualified higher education expenses only if the student incurring such expenses is enrolled at an eligible educational institution on at least a half-time basis.

Termination of education IRAs.—Under the conference agreement, any balance remaining in an education IRA at the time a beneficiary becomes 30 years old must be distributed, and the earnings portion of such a distribution will be includible in gross income of the beneficiary and subject to an additional 10-percent penalty tax because the distribution was not for educational purposes. However, as under the Senate amendment, prior to the beneficiary reaching age 30, the conference agreement allows tax-free (and penalty-free) transfers and rollovers of account balances from one education IRA benefiting one beneficiary to another education IRA benefiting a different beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary.[41]

Interaction with qualified State tuition programs.—The conference agreement provides that no contribution may be made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary.

Interaction with HOPE credit and Lifetime Learning credit.—The conference agreement provides that, in any taxable year in which an exclusion from gross income is claimed with respect to a distribution from an education IRA on behalf of a beneficiary, neither a HOPE credit nor a Lifetime Learning credit may be claimed with respect to educational expenses incurred during that year on behalf of the same beneficiary. The HOPE credit or Lifetime Learning credit will be available in other taxable years with respect to that beneficiary (provided that no exclusion is claimed in such

[40] The conference agreement clarifies that no amount is includible in the gross income of a beneficiary of an education IRA with respect to any contribution to or earnings on such account.

[41] For this purpose, a "member of the family" means—as under the conference agreement modifications to section 529—persons described in paragraphs (1) through (8) of section 152(a), and any spouse of such persons.

other taxable years for distributions from an education IRA on behalf of the beneficiary and provided that the requirements of the HOPE credit or Lifetime Learning credit are satisfied in such other taxable years).

Effective date.—The provisions governing education IRAs apply to taxable years beginning after December 31, 1997.

Estate and gift tax treatment

The conference agreement follows the House bill with respect to the estate and gift tax treatment of contributions to qualified State tuition programs and education IRAs, except that a special rule is provided in the case of contributions that exceed the annual gift tax exclusion limit (presently $10,000 in the case of an individual or $20,000 in the case of a married couple that splits their gifts, but this amount is scheduled to increase under other provisions of the conference agreement). For such contributions, the contributor may elect to have the contribution treated as if made ratably over a five-year period.

Thus, for Federal estate and gift tax purposes, any contribution to a qualified tuition program or education IRA will be treated as a completed gift of a present interest from the contributor to the beneficiary at the time of the contribution. Annual contributions are eligible for the present-law gift tax exclusion provided by Code section 2503(b) and also are excludable for purposes of the generation-skipping transfer tax (provided that the contribution, when combined with any other contributions made by the donor to that same beneficiary, does not exceed the annual gift-tax exclusion limit of $10,000, or $20,000 in the case of a married couple).

If a contribution in excess of $10,000 ($20,000 in the case of a married couple) is made in one year—which, under the conference agreement, can occur only in the case of a qualified State tuition program and not an education IRA (which cannot receive contributions in excess of $500 per year)—the contributor may elect to have the contribution treated as if made ratably over five years beginning in the year the contribution is made. For example, a $30,000 contribution to a qualified State tuition program would be treated as five annual contributions of $6,000, and the donor could therefore make up to $4,000 in other transfers to the beneficiary each year without payment of gift tax. Under this rule, a donor may contribute up to $50,000 every five years ($100,000 in the case of a married couple) with no gift tax consequences, assuming no other gifts are made from the donor to the beneficiary in the five-year period. A gift tax return must be filed with respect to any contribution in excess of the annual gift-tax exclusion limit, and the election for five-year averaging must be made on the contributor's gift tax return.

If a donor making an over-$10,000 contribution dies during the five-year averaging period, the portion of the contribution that has not been allocated to the years prior to death is includible in the donor's estate. For example, if a donor makes a $40,000 contribution, elects to treat the transfer as being made over a five-year period, and dies the following year, $8,000 would be allocated to the year of contribution, another $8,000 would be allocated to the year of death, and the remaining $24,000 would be includible in the estate.

If a beneficiary's interest is rolled over to another beneficiary, there are no transfer tax consequences if the two beneficiaries are in the same generation. If a beneficiary's interest is rolled over to a beneficiary in a lower generation (e.g., parent to child or uncle to niece), the five-year averaging rule described above may be applied to exempt up to $50,000 of the transfer from gift tax.

The Federal estate and gift tax treatment of educational accounts has no effect on the actual rights and obligations of the parties pursuant to the terms of the contracts under State law.

Effective date.—The gift tax provisions are effective for contributions (or transfers) made after the date of enactment, and the estate tax provisions are effective for decedents dying after June 8, 1997.

3. Phase out qualified tuition reduction exclusion (sec. 202(c) of the House bill)

Present Law

Under present law, a "qualified tuition reduction" is excluded from gross income (sec. 117(d)). A "qualified tuition reduction" means any reduction in tuition provided to an employee of an educational organization for the education of the employee,[42] the employee's spouse, and dependent children at that organization or another such organization. For this purpose, qualifying educational organizations are those that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where the educational activities are regularly carried out. In general, the qualified tuition reduction is limited to education below the graduate level; however, this limitation does not apply to graduate students engaged in teaching or research activities. The exclusion does not apply to any amount that represents payment for teaching, research, or other services rendered by the student in exchange for receiving the tuition reduction.

House Bill

The House bill phases out the special rule contained in section 117(d) that excludes qualified tuition reductions from gross income. For 1998, 80 percent of a qualified tuition reduction is excludable from gross income. For 1999, the excludable percentage is 60 percent; for 2000, the excludable percentage is 40 percent; and for 2001, the excludable percentage is 20 percent. No exclusion for a qualified tuition reduction is permitted after 2001.

Effective date.—The provision is effective for qualified tuition reductions with respect to courses of instruction beginning after December 31, 1997 (subject to the phaseout described above).

[42] Eligible beneficiaries also include retired and disabled employees, surviving spouses of retired or disabled employees, and children of deceased employees if the children are under the age of 25.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

4. Deduction for student loan interest (sec. 202 of the Senate amendment)

Present Law

The Tax Reform Act of 1986 repealed the deduction for personal interest. Student loan interest generally is treated as personal interest and thus is not allowable as an itemized deduction from income.

Taxpayers generally may not deduct education and training expenses. However, a deduction for education expenses generally is allowed under section 162 if the education or training (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162–5). Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses relate to the employee's current job and only to the extent that the expenses, along with other miscellaneous deductions, exceed 2 percent of the taxpayer's adjusted gross income (AGI).

House Bill

No provision.

Senate Amendment

Under the Senate amendment, certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, up to a maximum deduction of $2,500 per year. The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Months during which the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year. Beginning in 1999, the maximum deduction of $2,500 is indexed for inflation, rounded down to the closest multiple of $50.

A qualified education loan generally is defined as any indebtedness incurred to pay for the qualified higher education expenses of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income under section 135 (i.e., United States savings bonds used to pay higher education tuition and fees), (2) any amount distributed from a qualified tuition program or education investment account and excluded from gross income (under the provision described above), and (3) the amount of any scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127. Such expenses must be paid or incurred within a reasonable period before or after the indebtedness is incurred, and must be attributable to a period when the student is at least a half-time student.

The deduction is phased out ratably for taxpayers with modified adjusted gross income (AGI) between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). Modified AGI includes amounts otherwise excluded with respect to income earned abroad (or income from Puerto Rico or U.S. possessions), and is calculated after application of section 86 (income inclusion of certain Social Security benefits), section 219 (deductible IRA contributions), and section 469 (limitation on passive activity losses and credits).[43] Beginning in 2001, the income phase-out ranges are indexed for inflation, rounded down to the closest multiple of $5,000.

Any person in a trade or business or any governmental agency that receives $600 or more in qualified education loan interest from an individual during a calendar year must provide an information report on such interest to the IRS and to the payor.

Effective date.—The provision is effective for payments of interest due after December 31, 1996, on any qualified education loan. Thus, in the case of already existing qualified education loans, interest payments qualify for the deduction to the extent that the 60-month period has not expired. For purposes of counting the 60 months, any qualified education loan and all refinancing (that is treated as a qualified education loan) of such loan are treated as a single loan.

Conference Agreement

The conference agreement follows the Senate amendment, except that the maximum deduction is phased in over 4 years, with a $1,000 maximum deduction in 1998, $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001. The maximum deduction amount is not indexed for inflation. In addition, the deduction is phased out ratably for individual taxpayers with modified AGI of $40,000-$55,000

[43] For purposes of sections 86, 135, 219, and 469, adjusted gross income is determined without regard to the deduction for student loan interest.

($60,000–$75,000 for joint returns); such income ranges will be indexed for inflation occurring after the year 2002, rounded down to the closest multiple of $5,000. Thus, the first taxable year for which the inflation adjustment could be made will be 2003. For purposes of the deduction, modified AGI includes amounts excludable from gross income under section 137 (qualified adoption expenses).[44]

Qualified higher education expenses are defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses), reduced by (1) any amount excluded from gross income under section 135, (2) any amount distributed from an education IRA and excluded from gross income, and (3) the amount of any scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.

The conferees expect that the Secretary of Treasury will issue regulations setting forth reporting procedures that will facilitate the administration of this provision. Specifically, such regulations should require lenders separately to report to borrowers the amount of interest that constitutes deductible student loan interest (i.e., interest on a qualified education loan during the first 60 months in which interest payments are required). In this regard, the regulations should include a method for borrower certification to a lender that the loan proceeds are being used to pay for qualified higher education expenses.

The provision is effective for interest payments due and paid after December 31, 1997, on any qualified education loan.

5. Penalty-free withdrawals from IRAs for higher education expenses (sec. 203 of the House bill and Senate amendment)

Present Law

Under present law, amounts held in an individual retirement arrangement ("IRA") are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). 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 or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, or is used to purchase health insurance of an unemployed individual.

House Bill

The House bill provides that the 10-percent early withdrawal tax does not apply to distributions from IRAs if the taxpayer used the amounts to pay qualified higher education expenses (including those related to graduate level courses) of the taxpayer, the tax-

[44] For purposes of section 137, adjusted gross income is determined without regard to the deduction for student loan interest.

payer's spouse, or any child, or grandchild of the individual or the individual's spouse.

The penalty-free withdrawal is available for "qualified higher education expenses," meaning tuition, fees, books, supplies, equipment required for enrollment or attendance, and room and board at a post-secondary educational institution (defined by reference to sec 481 of the Higher Education Act of 1965). Qualified higher education expenses are reduced by any amount excludable from gross income under section 135 relating to the redemption of a qualified U.S. savings bond and certain scholarships and veterans benefits.

Effective date.—The provision is effective for distributions made after December 31, 1997, which respect to expenses paid after such date for education furnished in academic periods beginning after such date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

6. Tax credit for expenses for education which supplements elementary and secondary education (sec. 204 of the House bill)

Present Law

In general, taxpayers may not deduct education and training expenses that relate to basic elementary or secondary education. (Treas. reg. sec. 1.162–5). Students who are employed may be eligible for the special exclusion for employer-provided educational assistance under section 127. In addition, qualified scholarships received by such students are excluded from gross income under section 117, and such students may be eligible for the special rules for student loan forgiveness under section 108(f). No tax credit is available under present law for expenses incurred with respect to elementary or secondary education.

House Bill

The House bill provides a nonrefundable tax credit equal to the lesser of (1) $150 or (2) 50 percent of qualified educational assistance expenses paid with respect to an eligible student.

Eligible students are children under age 18 enrolled full-time in elementary or secondary school. Qualified educational assistance expenses are costs of supplementary education (e.g., tutoring). Such supplementary education must be provided with respect to a student's current classes by a supplementary education service provider that is accredited by an accreditation organization recognized by the Secretary of Education. Qualified expenses do not include the cost of courses that prepare students for college entrance exams.

The credit is phased out for taxpayers with adjusted gross income between $80,000–$92,000 for joint filers and between $50,000–$62,000 for individual filers.

Effective date.—The credit is available for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

7. Certain teacher education expenses not subject to 2-percent floor on miscellaneous itemized deductions (sec. 224 of the Senate amendment)

Present Law

In general, taxpayers are not permitted to deduct education expenses. However, employees may deduct the cost of certain work-related education. For costs to be deductible, the education must either be required by the taxpayer's employer or by law to retain taxpayer's current job or be necessary to maintain or improve skills required in the taxpayer's current job. Expenses incurred for education that is necessary to meet minimum education requirements of an employee's present trade or business or that can qualify an employee for a new trade or business are not deductible.

An employee is allowed to deduct work-related education and other business expenses only to the extent such expenses (together with other miscellaneous itemized deductions) exceed 2 percent of the taxpayer's adjusted gross income.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, qualified professional development expenses incurred by an elementary or secondary school teacher [45] with respect to certain courses of instruction are not subject to the 2-percent floor on miscellaneous itemized deductions. Qualified professional development expenses mean expenses for tuition, fees, books, supplies, equipment and transportation required for enrollment or attendance in a qualified course, *provided* that such expenses are otherwise deductible under present law section 162. A qualified course of instruction means a course at an institution of higher education (as defined in sec. 481 of the Higher Education Act of 1965) which is part of a program of professional development that is approved and certified by the appropriate local educational agency as furthering the individual's teaching skills.

[45] To be eligible, a teacher must have completed at least two academic years as a K–12 teacher in an elementary or secondary school before the qualified professional development expenses are incurred.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

B. Other Education-Related Tax Provisions

1. Extension of exclusion for employer-provided educational assistance (sec. 221 of the House bill and sec. 221 of the Senate amendment)

Present Law

Under present law, an employee's gross income and wages do not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts are paid or incurred pursuant to an educational assistance program that meets certain requirements. This exclusion is limited to $5,250 of educational assistance with respect to an individual during a calendar year. The exclusion does not apply to graduate-level courses beginning after June 30, 1996. The exclusion expires with respect to courses of instruction beginning after June 30, 1997.[46] In the absence of the exclusion, educational assistance is excludable from income only if it is related to the employee's current job.

House Bill

The exclusion for employer-provided educational assistance is extended through courses beginning on or before December 31, 1997.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1996.

Senate Amendment

The exclusion for employer-provided educational assistance is extended permanently. Beginning in 1997, the exclusion applies to graduate-level courses.

Effective date.—The extension of the exclusion with respect to undergraduate courses applies with respect to taxable years beginning after December 31, 1996. The extension of the exclusion with respect to graduate-level courses applies to courses beginning after December 31, 1996.

Conference Agreement

The conference agreement follows the House bill, with modifications. Under the conference agreement, the exclusion for undergraduate education is extended with respect to courses beginning before June 1, 2000. As under the House bill, the exclusion does not apply with respect to graduate-level courses.

[46] The legislative history reflects congressional intent that the provision expire with respect to courses beginning after May 31, 1997.

2. Modification of $150 million limit on qualified 501(c)(3) bonds other than hospital bonds (sec. 222 of the House bill and sec. 222 of the Senate amendment)

Present Law

Interest on State and local government bonds generally is excluded from income if the bonds are issued to finance activities carried out and paid for with revenues of these governments. Interest on bonds issued by these governments to finance activities of other persons, e.g., private activity bonds, is taxable unless a specific exception is included in the Code. One such exception is for private activity bonds issued to finance activities of private, charitable organizations described in Code section 501(c)(3) ("section 501(c)(3) organizations") when the activities do not constitute an unrelated trade or business.

Present law treats section 501(c)(3) organizations as private persons; thus, bonds for their use may only be issued as private activity "qualified 501(1)(3) bonds," subject to the restrictions of Code section 145. The most significant of these restrictions limits the amount of outstanding bonds from which a section 501(c)(3) organization may benefit to $150 million. In applying this "$150 million limit," all section 501(c)(3) organizations under common management or control are treated as a single organization. The limit does not apply to bonds for hospital facilities, defined to include only acute care, primarily inpatient, organizations.

House Bill

Under the House bill, the $150 million limit is increased annually in $10 million increments until it is $200 million. Specifically, the limitation is $160 million in 1998, $170 million in 1999, $180 million in 2000, $190 million in 2001, and $200 million in 2002 and thereafter.

Effective date.—The provision is effective on January 1, 1998.

Senate Amendment

The Senate amendment repeals the $150 million limit for bonds issued after the date of enactment to finance capital expenditures incurred after the date of enactment.

Effective date.—The provision is effective for bonds issued after the date of enactment to finance capital expenditures incurred after such date.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective for bonds issued after the date of enactment. Because this provision of the conference agreement applies only to bonds issued with respect to capital expenditures incurred after the date of enactment, the $150 million limit will continue to govern issuance of other non-hospital qualified 501(c)(3) bonds (e.g., refunding bonds or new-money bonds for capital expenditures incurred before the date of enactment). Thus, the conferees understand that bond issuers will continue to need

Treasury Department guidance on the application of this limit in the future and expect that the Treasury will continue to provide interpretative rules on this limit.

3. Enhanced deduction for corporate contributions of computer technology and equipment (sec. 223 of the House bill)

Present Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.[47] However, in the case of a charitable contribution of inventory or other ordinary-income property, short-term capital gain property, or certain gifts to private foundations, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, a taxpayer's deduction is limited to the adjusted basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose (sec. 170(e)(1)(B)(I)).

Special rules in the Code provide augmented deductions for certain corporate[48] contributions of inventory property for the care of the ill, the needy, or infants (sec. 170(e)(3)), and certain corporate contributions of scientific equipment constructed by the taxpayer, provided the original use of such donated equipment is by the donee for research or research training in the United States in physical or biological sciences (sec. 170(e)(4)).[49] Under these special rules, the amount of the augmented deduction available to a corporation making a qualified contribution is equal to its basis in the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold. However, the augmented deduction cannot exceed twice the basis of the donated property.

House Bill

The House bill expands the list of qualified contributions that would qualify for the augmented deduction currently available under Code section 170(e)(3) and 170(e)(4). Under the House bill, qualified contributions mean gifts of computer technology and equipment (i.e., computer software, computer or peripheral equipment, and fiber optic cable related to computer use) to be used within the United States for educational purposes in any of grades K–12.

Eligible donees are: (1) any educational organization that normally maintains a regular faculty and curriculum and has a regu-

[47] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). Corporations are entitled to claim a deduction for charitable contributions, generally limited to 10 percent of their taxable income (computed without regard to the contributions) for the taxable year.

[48] S corporations are not eligible donors for purposes of section 170(e)(3) or section 170(e)(4).

[49] Eligible donees under section 170(e)(4) are limited to post-secondary educational institutions, scientific research organizations, and certain other organizations that support scientific research.

larly enrolled body of pupils in attendance at the place where its educational activities are regularly carried on; and (2) Code section 501(c)(3) entities that are organized primarily for purposes of supporting elementary and secondary education. A private foundation also is an eligible donee, provided that, within 30 days after receipt of the contribution, the private foundation contributes the property to an eligible donee described above.

Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. Such donated property could be computer technology or equipment that is inventory or depreciable trade or business property in the hands of the donor. The House bill permits payment by the donee organization of shipping, transfer, and installation costs.[50] The special treatment applies only to donations made by C corporations; as under present law section 170(e)(4), S corporations, personal holding companies, and service organizations are not eligible donors.

Effective date.—The provision is effective for contributions made in taxable years beginning after 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the provision is sunset after three years. Thus, the provision is effective for contributions made in taxable years beginning after 1997 and before January 1, 2001. In addition, the conference agreement clarifies that the original use of the donated property must commence with the donor or the donee. Accordingly, qualified contributions generally are limited to property that is no more than two years old.

4. Expansion of arbitrage rebate exception for certain bonds (sec. 223 of the Senate amendment)

Present Law

Generally, all arbitrage profits earned on investments unrelated to the purpose of the borrowing ("nonpurpose investments") when such earnings are permitted must be rebated to the Federal Government.

An exception is provided for bonds issued by governmental units having general taxing powers if the governmental unit (and all subordinate units) issues $5 million or less of governmental bonds during the calendar year ("the small-issuer exception"). This exception does not apply to private activity bonds.

House Bill

No provision.

[50] In the case of contributions made through private foundations, the bill permits the payment by the private foundation of shipping, transfer, and installation costs.

Senate Amendment

The Senate amendment provides that up to $5 million of bonds used to finance public school capital expenditures incurred after December 31, 1997, are excluded from application of the present-law $5 million limit. Thus, small issuers will continue to benefit from the small issue exception from arbitrage rebate if they issue no more than $10 million in governmental bonds per calendar year and no more than $5 million of the bonds is used to finance expenditures other than for public school capital expenditures.

Effective date.—The provision is effective for bonds issued after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Treatment of cancellation of certain student loans (sec. 224 of the House bill and sec. 225 of the Senate amendment)

Present Law

In the case of an individual, gross income subject to Federal income tax does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers (sec. 108(f)).

Student loans eligible for this special rule must be made to an individual to assist the individual in attending an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of students in attendance at the place where its education activities are regularly carried on. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses (in contrast to tax-free scholarships under section 117, which are limited to tuition and required fees). In addition, the loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation. Thus, loans made with private, nongovernmental funds are not qualifying student loans for purposes of the section 108(f) exclusion.

House Bill

The House bill expands section 108(f) so that an individual's gross income does not include forgiveness of loans made by tax-exempt charitable organizations (e.g., educational organizations or private foundations) if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance outstanding student loans and the student is not employed by the lender organization. As under present law, the section 108(f) exclusion applies only if the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers. In addition, in the case of loans made by tax-exempt charitable organizations, the student's work must fulfill a public service requirement. The student must work in an occupation or area with unmet needs and such work must be performed for or under the direction of a tax-exempt charitable organization or a governmental entity.

The exclusion also is expanded to cover forgiveness of direct student loans made through the William D. Ford Federal Direct Loan Program where loan repayment and forgiveness are contingent on the borrower's income level and any unpaid amounts are forgiven in full by the Secretary of Education at the end of a 25-year period. Thus, Federal Direct Loan borrowers who have elected the income-contingent repayment option and who have not repaid their loans in full at the end of a 25-year period would not be required to include the outstanding loan balance in income as a result of the forgiveness of the loan.

Effective date.—The provision applies to discharges of indebtedness after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, except that the conference agreement does not include the provision expanding the exclusion to cover forgiveness of direct student loans made through the William D. Ford Federal Direct Loan Program where loan repayment and forgiveness are contingent on the borrower's income level and any unpaid amounts are forgiven in full by the Secretary of Education at the end of a 25-year period.

6. Tax credit for holders of qualified zone academy bonds

Present Law

Under present law, interest on bonds issued for general governmental purposes, including public schools, is exempt from Federal income tax.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

Under the conference agreement, certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold "qualified zone academy bonds" are entitled to a nonrefundable tax credit in an amount equal to a credit rate (set by the Treasury Department) multiplied by the face amount of the bond. The credit rate applies to all such bonds purchased in each month. A taxpayer holding a qualified zone academy bond is entitled to a credit for each year the taxpayer holds the bond. The credit is includible in gross income, but may be claimed against regular income tax and AMT liability.

The Treasury Department will set the credit rate each month so that such bonds can be issued without discount and without any interest cost to the issuer. The maximum term of the bond issued in a given month also is determined by the Treasury Department so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Such present value will be determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

"Qualified zone academy bonds" are defined as any bond issued by a State or local government, provided that (1) 95 percent of the proceeds are used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in an empowerment zone or enterprise community (including empowerment zones designated or authorized to be designated under the conference agreement), or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

A total of $400 million of "qualified zone academy bonds" may be issued in each of 1998 and 1999. The $800 million aggregate bond cap will be allocated to the States according to their respective populations of individuals below the poverty line. A State may carry over any unused allocation into subsequent years. Each State, in turn, will allocate the credit to qualified zone academies within such State.

Effective date.—The provision is effective for bonds issued after 1997.

III. SAVINGS AND INVESTMENT TAX INCENTIVES

A. Individual Retirement Arrangements

1. Increase deductible IRA phase-out range and modify active participant rule (sec. 301 of the Senate amendment)

Present Law

If an individual (or, if married, the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 IRA deduction limit is phased out over the following levels of adjusted gross income ("AGI"): $25,000 to $35,000 in the case of a single taxpayer and $40,000 to $50,000 in the case of married taxpayers.

House Bill

No provision.

Senate Amendment

An individual is not considered to be an active participant in an employer-sponsored retirement plan merely because the individual's spouse is such an active participant.

The income phase-out range for single individuals is increased as follows: for 1998 and 1999, the phase-out range is $30,000 to $40,000; for 2000 and 2001, $35,000 to $45,000; for 2002 and 2003, $40,000 to $50,000; and for 2004 and thereafter, $50,000 to $60,000.

The income phase-out range for married individuals is increased as follows: for 1998 and 1999, the phase-out range is $50,000 to $60,000; for 2000 and 2001, $60,000 to $70,000; for 2002 and 2003, $70,000 to $80,000; and 2004 and thereafter, $80,000 to $100,000.

Effective date.—The provisions are effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications.

Under the conference agreement, as under the Senate amendment, an individual is not considered an active participant in an employer-sponsored retirement plan merely because the individual's spouse is an active participant. However, under the conference agreement, the maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, is phased out for taxpayers with AGI between $150,000 and $160,000.

Under the conference agreement, the deductible IRA income phase-out limits are increased as follows:

	Phase-out range
Joint Returns	
Taxable years beginning in:	
1998	$50,000—$60,000
1999	$51,000—$61,000
2000	$52,000—$62,000
2001	$53,000—$63,000
2002	$54,000—$64,000
2003	$60,000—$70,000
2004	$65,000—$75,000
2005	$70,000—$80,000
2006	$75,000—$85,000
2007 and thereafter	$80,000—$100,000
Single Taxpayers	
Taxable years beginning in:	
1998	$30,000—$40,000
1999	$31,000—$41,000
2000	$32,000—$42,000
2001	$33,000—$43,000
2002	$34,000—$44,000
2003	$40,000—$50,000
2004	$45,000—$55,000
2005 and thereafter	$50,000—$60,000

The following examples illustrate the income phase-out rules.

Example 1.—Suppose for a year W is an active participant in an employer-sponsored retirement plan, and W's husband, H, is not. Further assume that the combined AGI of H and W for the year is $200,000. Neither W nor H is entitled to make deductible contributions to an IRA for the year.

Example 2.—Same as example 1, except that the combined AGI of W and H is $125,000. H can make deductible contributions to an IRA. However, a deductible contribution could not be made for W.

2. Tax-free nondeductible IRAs (sec. 301 of the House bill and sec. 302 of the Senate amendment)

Present Law

No provision. However, present law provides that an individual can make nondeductible contributions to an IRA to the extent the individual cannot or does not make deductible contributions. Earnings on nondeductible contributions are includible in income when withdrawn.

House Bill

In general

The House bill replaces present-law nondeductible IRAs with new American Dream IRAs ("AD IRAs") to which individuals may make nondeductible contributions of up to $2,000 annually. No income limits apply to AD IRAs, and contributions to AD IRAs are in addition to other IRA contributions. The $2,000 contribution limit is indexed for inflation in $50 increments.

Taxation of distributions

Qualified distributions from an AD IRA are not includible in income. Qualified distributions are distributions (1) made after the 5-taxable year period beginning with the first taxable year for which a contribution was made to an AD IRA and (2) which are (a) made on or after the date on which the individual attains age 59½, (b) made to a beneficiary on or after the death of the individual, (c) attributable to the individual's being disabled, or (d) for a qualified special purpose distribution. A qualified special purpose distribution is a distribution for first-time homebuyer expenses.

Conversions of IRAs to AD IRAs

An IRA may be converted to an AD IRA before January 1, 1999. Amounts that would have been includible in income had the amounts converted been withdrawn are includible in income ratably over 4 years. The additional tax on early withdrawals does not apply to conversions of IRAs to AD IRAs.

Effective date

Taxable years beginning after December 31, 1997.

Senate Amendment

In general

Same as the House bill, except that: (1) the new IRAs are called IRA Plus accounts and (2) no more than $2,000 of annual contributions can be made to all an individual's IRAs.

Taxation of distributions

Same as the House bill, except that special purpose distributions also include distributions to long-term unemployed individuals.

Conversions of IRAs to AD IRAs

Same as the House bill, except that conversions of an IRA to an IRA Plus can be made at any time. If the conversion is made before January 1, 1999, the amounts that would have been includible in income had the amounts converted been withdrawn are includible in income ratably over 4 years. In any case, the 10-percent tax on early withdrawals does not apply.

Effective date

Same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the new IRA is called the "Roth IRA" rather than the IRA Plus. The maximum contribution that can be made to a Roth IRA is phased out for individuals with AGI between $95,000 and $110,000 and for joint filers with AGI between $150,000 and $160,000. Under the conference agreement, distributions to long-term unemployed individuals do not qualify as special purpose distributions. Thus, only first-time homebuyer expenses (as defined under the Senate amendment) qualify as special purpose distributions.

Under the conference agreement, only taxpayers with AGI of less than $100,000 [51] are eligible to roll over or convert an IRA into a Roth IRA.

The conference agreement retains present-law nondeductible IRAs. Thus, an individual who cannot (or does not) make contributions to a deductible IRA or a Roth IRA can make contributions to a nondeductible IRA. In no case can contributions to all an individual's IRAs for a taxable year exceed $2,000.

3. Modifications to early withdrawal tax (sec. 301 of the House bill and sec. 303 of the Senate amendment)

Present Law

Under present law, a 10-percent additional tax applies to distributions from an IRA prior to age 59½, unless an exception applies.

House Bill

The House bill adds an additional exception to the early withdrawal tax for AD IRAs only. The early withdrawal tax does not apply to distributions from an AD IRA for first-time homebuyer expenses, subject to a $10,000 life-time cap.

Effective date.—Taxable years beginning after December 31, 1997.

Senate Amendment

The early withdrawal tax does not apply to distributions from any IRA for first-time homebuyer expenses or for long-term unemployed individuals.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment but does not include the provision relating to long-term unemployed individuals.[52]

4. IRA investments in coins and bullion (sec. 304 of the Senate amendment)

Present Law

IRA assets may not be invested in collectibles. This prohibition does not apply to certain gold and silver coins or to coins issued by a State.

House Bill

No provision.

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[51] For this purpose, AGI is determined before any amount includible in income as a result of the rollover or conversion.

[52] As under the House bill and Senate amendment, the conference agreement includes a penalty-free withdrawal provision for education expenses.

Senate Amendment

IRA assets may be invested in certain platinum coins and in certain gold, silver, platinum or palladium bullion.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

B. Capital Gains Provisions

1. Maximum rate of tax on net capital gain of individuals (sec. 311 of the House bill and sec. 311 of the Senate amendment)

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 of depreciation.

House Bill

Under the House bill, the maximum rate of tax on the net capital gain of an individual is reduced from 28 percent to 20 percent. In addition, any net capital gain which otherwise would be taxed at a 15-percent rate is taxed at a rate of 10 percent. These rates apply for purposes of both the regular tax and the minimum tax.

The tax on the net capital gain attributable to any long-term capital gain from the sale or exchange of collectibles will remain at a maximum rate of 28 percent; any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) to the extent the gain would have been treated as ordinary income if the property had been section 1245 property will be taxed at a maximum rate of 26 percent. Gain from the disposition of a collectible which is an indexed asset (described below) will not be eligible for the 28-percent rate unless the taxpayer elects to forgo indexing.

Effective date.—The provision generally applies to sales and exchanges (and installment payments received) after May 6, 1997.

Senate Amendment

The Senate amendment is the same as the House bill except the maximum rate on gain attributable to the depreciation of section 1250 property is 24 percent (rather than 26 percent). (Differences in the provisions relating to indexing and small business stock are described below.)

Effective date.—The effective date is the same as the House bill.

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment. The maximum rate of tax on gain attributable to the depreciation of section 1250 property will be 25 percent.

In addition, for taxable years beginning after December 31, 2000, the maximum capital gains rates for assets which are held more than 5 years, are 8 percent and 18 percent (rather than 10 percent and 20 percent). The 18-percent rate only applies to assets the holding period for which begins after December 31, 2000. A taxpayer holding a capital asset or asset used in the taxpayer's trade or business on January 1, 2001, may elect to treat the 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, any gain is recognized (and any loss disallowed). The conference agreement allows the Treasury Department to issue regulations coordinating the capital gain provisions with other rules involving the treatment of sales and exchanges by pass-thru entities and of interests therein.

Under the conference agreement, the lower capital gains rates do not apply to the sale or exchange of assets held for 18 months or less, effective for amounts properly taken into account after July 28, 1997. The 28-percent maximum rate will continue to apply to the sale or exchange of capital assets held more than 1 year but not more than 18 months.

2. Small business stock (sec. 311 of the House bill and secs. 312 and 313 of the Senate amendment)

Present Law

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

The amount of gain eligible for the 50-percent exclusion by an individual with respect to any corporation is the greater of (1) 10 times the taxpayer's basis in the stock or (2) $10 million.

In order to qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed $50 million. The corporation also must meet an active trade or business requirement.

House Bill

Under the House bill, the lower capital gains rates do not apply to the includible portion of the gain from the qualifying sale of small business stock. Thus, the maximum rate of regular tax on the sale of small business stock remains at 14 percent.

Senate Amendment

Under the Senate amendment, the 50-percent exclusion will apply to small business stock (other than stock of a subsidiary corporation) held by a corporation. The minimum tax preference is repealed. Under the provision, in the case of a qualifying sale of small business stock by an individual, the maximum rate of tax, will be 10 percent.

The Senate amendment increases the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million. The Senate amendment also repeals the limitation on the amount of gain a taxpayer can exclude with respect to the stock of any corporation.

The Senate amendment provides that certain working capital must be expended within five years (rather than two years) in order to be treated as used in the active conduct of a trade or business. No limit on the percent of the corporation's assets that are working capital is imposed.

The Senate amendment provides that if the corporation establishes a business purpose for a redemption of its stock, that redemption is disregarded in determining whether other newly issued stock could qualify as eligible stock.

The Senate amendment allows a taxpayer to roll over gain from the sale or exchange of small business stock held more than five years where the taxpayer uses the proceeds to purchase other small business stock within 60 days of the sale of the original stock. If the taxpayer sells the replacement stock, any gain attributable to the original stock is treated as gain from the sale or exchange of small business stock held more than five years, and any remaining gain will be so treated after the replacement stock is held for at least five years. In addition, any gain that otherwise would be recognized from the sale of the replacement stock can be rolled over to other small business stock purchased within 60 days.

Effective date.—The increase in the size of corporations whose stock is eligible for the exclusion applies to stock issued after the date of the enactment of the proposal. The remaining provisions apply to stock issued after August 10, 1993 (the original effective date of the small business stock provision).

Conference Agreement

The conference agreement follows the provisions in the House bill. The conference agreement reduces the minimum tax preference from one-half of the excluded gain to 42 percent of such gain.

In addition, the conference agreement allows an individual to roll over tax-free gain from the sale or exchange of qualified small business stock held more than 6 months where the taxpayer uses the proceeds to purchase other qualified small business stock within 60 days of the sale. For purposes of the rollover provision, the replacement stock must meet the active business requirement for the 6-month period following the purchase. Generally, the holding period of the stock purchased will include the holding period of the stock sold, except for purposes of determining whether the 6-month holding period is met. The provision applies to sales after the date of enactment of this Act.

3. Indexing of basis of certain assets for purposes of determining gain (sec. 312 of the House bill)

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.

House Bill

The House bill generally provides for an inflation adjustment to (i.e., indexing of) the adjusted basis of certain assets (called "indexed assets") held more than three years 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 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. A personal residence is not eligible for indexing. To be eligible for indexing, an asset must be held by the taxpayer for more than three years.

The inflation adjustment under the provision is computed by multiplying the taxpayer's adjusted basis in the indexed asset by an inflation adjustment percentage, based on the chain-type price index for GDP ("Gross Domestic Product').

Special rules apply to RICS, REITS, partnerships, S corporations and common trust funds.

Effective date.—The provision applies to property the holding period of which begins after December 31, 2000. A taxpayer holding any indexed asset on January 1, 2001, 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, any gain is recognized (and any loss is disallowed).

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

4. Exclusion of gain on sale of principal residence (sec. 313 of the House bill and sec. 314 of the Senate amendment)

Present Law

Under present law, no gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his or her principal residence within a specified period of time (sec. 1034). This replacement period generally begins two years before and ends two years after the date of sale of the old residence. The basis of the replacement residence is reduced by the amount of any gain not recognized on the sale of the old residence by reason of this gain rollover rule.

Also, under present law, in general, an individual, on a one-time basis, may exclude from gross income up to $125,000 of gain from the sale or exchange of a principal residence if the taxpayer (1) has attained age 55 before the sale, and (2) has owned the property and used it as a principal residence for three or more of the five years preceding the sale (sec. 121).

House Bill

Under the House bill, a taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. The exclusion is allowed each time a taxpayer selling or exchanging a principal residence meets the eligibility requirements, but generally no more frequently than once every two years. The House bill provides that gain would be recognized to the extent of any depreciation allowable with respect to the rental or business use of such principal residence for periods after May 6, 1997.

To be eligible for the exclusion, a taxpayer must have owned the residence and occupied it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or other unforseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

In the case of joint filers not sharing a principal residence, an exclusion of $250,000 is available on a qualifying sale or exchange of the principal residence of one of the spouses. Similarly, if a single taxpayer who is otherwise eligible for an exclusion marries someone who has used the exclusion within the two years prior to the marriage, the bill would allow the newly married taxpayer a maximum exclusion of $250,000. Once both spouses satisfy the eligibility rules and two years have passed since the last exclusion was allowed to either of them, the taxpayers may exclude $500,000 of gain on their joint return.

Under the bill, the gain from the sale or exchange of the remainder interest in the taxpayer's principal residence may qualify for the otherwise allowable exclusion.

Effective date.—The provision is available for all sales or exchanges of a principal residence occurring after May 6, 1997, and replaces the present-law rollover and one-time exclusion provisions applicable to principal residences.

A taxpayer may elect to apply present law (rather than the new exclusion) to a sale or exchange (1) made before the date of enactment of the Act, (2) made after the date of enactment pursuant to a binding contract in effect on such date or (3) where the replacement residence was acquired on or before the date of enactment (or pursuant to a binding contract in effect of the date of enactment) and the rollover provision would apply. If a taxpayer acquired his or her current residence in a rollover transaction, periods of ownership and use of the prior residence would be taken into account in determining ownership and use of the current residence.

Senate Amendment

The Senate amendment is the same as the House bill with technical modifications.

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment.

The conferees wish to clarify that the provision limiting the exclusion to only one sale every two years by the taxpayer does not prevent a husband and wife filing a joint return from each excluding up to $250,000 of gain from the sale or exchange of each spouse's principal residence provided that each spouse would be permitted to exclude up to $250,000 of gain if they filed separate returns.

5. Corporate capital gains (sec. 321 of the House bill)

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.

House Bill

The House bill provides an maximum rate of tax on the net capital gain of a corporation to the extent the gain is attributable to the sale or exchange of property held more than 8 years. The alternative tax is 32 percent on gain attributable to calendar year 1998; 31 percent on gain attributable to calendar year 1999; and 30 percent on gain attributable to calendar years after 1999. The House bill also modifies the application of the corporate alternative capital gains tax so that the alternative capital gains tax applies to the lesser of 8-year gain or taxable income. Gain from the disposition of a collectible or attributable to the depreciation of section 1250 property is not eligible for the lower rate.

Effective date.—The provision applies to taxable years ending after December 31, 1997. However, the lower rate does not apply to amounts properly taken into account before January 1, 1998. For fiscal years beginning in 1998 and 1999, the tax is computed by applying the applicable percentage to the 8-year gain for the first portion of the year (or, if less, the 8-year gain for the entire year), but in an amount not to exceed the taxable income for the entire year and then by applying the applicable percentage to an amount equal to the 8-year gain for the entire year (or, if less, taxable income) reduced by the amount taxed at the applicable percentage for the first portion of the year.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

The conference agreement provides that the amount of gain subject to the alternative rate of tax under section 1201(a)(2) may not exceed the corporation's taxable income. Because the section 1201 alternative tax does not presently apply, this change has no effect under the rate structure of present law.

IV. ALTERNATIVE MINIMUM TAX PROVISIONS

A. Increase Exemption Amount Applicable to Individual Alternative Minimum Tax (sec. 401 of the House bill and sec. 102 of the Senate amendment)

Present Law

Present law imposes a minimum tax on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. This alternative minimum tax is imposed upon individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income in excess of a phased-out exemption amount and (2) 28 percent on the amount in excess of $175,000. The exemptions amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return. These exemption amounts are phased-out by an amount equal to 25 percent of the amount that the individual's alternative minimum taxable income exceeds a threshold amount. These threshold amounts are $150,000 in the case of married individuals filing a joint return and surviving spouses; $112,500 in the case of other unmarried individuals; and $75,000 in the case of married individuals filing a separate return, estates, and trusts. The exemption amounts, the threshold phase-out amounts, and the $175,000 break-point amount are not indexed for inflation.

House Bill

For taxable years beginning in 1999, 2001, 2003, 2005 and 2007, the exemption amounts of the individual alternative minimum tax are increased as follows for each such year: (1) by $1,000 in the case of married individuals filing a joint return and surviving spouses; (2) by $750 in the case of other unmarried individuals; and (3) by $500 in the case of married individuals filing a separate return. For taxable years beginning after 2007, the exemption amounts are indexed for inflation.

Effective date.—The provision is effective for taxable years beginning after December 31, 1998.

Senate Amendment

For taxable years beginning after 2000 and before 2003, the exemption amounts of the individual alternative minimum tax are increased as follows in each year: (1) by $600 in the case of married individuals filing a joint return and surviving spouses; (2) by $450 in the case of other unmarried individuals; and (3) by $300 in the case of married individuals filing separate returns. For taxable years beginning after 2003, the exemption amounts of the individual alternative minimum tax are increased as follows in each year: (1) by $950 in the case of married individuals filing a joint return and surviving spouses; (2) by $700 in the case of other unmarried individuals; and (3) by $475 in the case of married individuals filing separate returns.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement contains neither the House bill nor the Senate amendment.

B. Repeal Alternative Minimum Tax for Small Businesses and Repeal the Depreciation Adjustment (secs. 402 and 403 of the House bill)

Present Law

Present law imposes a minimum tax 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. 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.

The most significant alternative minimum tax adjustment relates to depreciation. In computing AMTI, depreciation on property placed in service after 1986 must be computed by using the class lives prescribed by the alternative depreciation system of section 168(g) and either (1) the straight-line method in the case of property subject to the straight-line method under the regular tax or (2) the 150-percent declining balance method in the case of other property. For regular tax purposes, depreciation on tangible personal property generally is computed using shorter recovery periods and more accelerated methods than are allowed for alternative minimum tax purposes.

House Bill

Repeal of the corporate alternative minimum tax for small businesses

The corporate alternative minimum tax is repealed for small business corporations for taxable years beginning after December 31, 1997. A corporation that had average gross receipts of less than $5 million for the three-year period beginning after December 31, 1994, is a small business corporation for any taxable year beginning after December 31, 1997. A corporation that meets the $5 million gross receipts test will continue to be treated as small business corporation exempt from the alternative minimum tax so long as its average gross receipts do not exceed $7.5 million. A corporation that fails to meet the $7.5 million gross receipts test will become subject to corporate alternative minimum tax only with respect to preferences and adjustments that relate to transactions and investments entered into after the corporation loses its status as a small business corporation.

In addition, the alternative minimum tax credit allowable to a small business corporation is limited to the amount by which corporation's regular tax liability (reduced by other credits) exceeds 25 percent of the excess (if any) of the corporation's regular tax (reduced by other credits) over $25,000.

Repeal of the depreciation adjustment

The alternative minimum tax adjustment relating to depreciation is repealed for all taxpayers for property placed in service after December 31, 1998.

Effective date

Except as provided above, the provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement generally follows the House bill with respect to the repeal of the corporate alternative minimum tax for small businesses. In addition, for property (including pollution control facilities) placed in service after December 31, 1998, the conference agreement conforms the recovery periods used for purposes of the alternative minimum tax depreciation adjustment to the recovery periods used for purposes of the regular tax under present law.

C. Repeal AMT Installment Method Adjustment for Farmers (sec. 404 of the House bill and sec. 732 of the Senate amendment)

Present Law

The installment method allows gain on the sale of property to be recognized as payments are received. Under the regular tax, dealers in personal property are not allowed to defer the recognition of income by use of the installment method on the installment sale of such property. For this purpose, dealer dispositions do not include sales of any property used or produced in the trade or business of farming. For alternative minimum tax purposes, the installment method is not available with respect to the disposition of any property that is the stock in trade of the taxpayer or any other property of a kind which would be properly included in the inventory of the taxpayer if held at year end, or property held by the taxpayer primarily for sale to customers. No explicit exception is provided for installment sales of farm property under the alternative minimum tax.

House Bill

The House bill generally provides that for purposes of the alternative minimum tax, farmers may use the installment method of accounting.

Effective date.—The provision generally is effective for dispositions in taxable years beginning after December 31, 1987, with a special rule for dispositions occurring in 1987.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

V. ESTATE, GIFT, AND GENERATION-SKIPPING TAX PROVISIONS

A. Estate and Gift Tax Provisions

1. Increase in estate and gift tax unified credit (sec. 501(a) of the House bill and sec. 401(a) of the Senate amendment)

Present Law

A gift tax is imposed on lifetime transfers by gift 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.[53] A unified credit of $192,800 is provided against the estate and gift tax, which effectively exempts the first $600,000 in cumulative taxable transfers from tax (sec. 2010). For transfers in excess of $600,000, estate and gift tax rates begin at 37 percent and reach 55 percent on cumulative taxable transfers over $3 million (sec. 2001(c)). In addition, a 5-percent surtax is imposed upon cumulative taxable transfers between $10 million and $21,040,000, to phase out the benefits of the graduated rates and the unified credit (sec. 2001(c)(2)).[54]

House Bill

The House bill increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2007. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $650,000 for decedents dying and gifts made in 1998; $750,000 in 1999; $765,000 in 2000; $775,000 in 2001 through 2004; $800,000 in 2005; $825,000 in 2006; $1 million in 2007. After 2007, the effective exemption is indexed annually for inflation. The indexed exemption amount is rounded to the next lowest multiple of $10,000.

Conforming amendments to reflect the increased unified credit are made (1) to the 5-percent surtax to conform the phase out of the increased unified credit and graduated rates, (2) to the general filing requirements for an estate tax return under section 6018(a), and (3) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

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

[54] Thus, if a taxpayer has made cumulative taxable transfers equaling $21,040,000 or more, his or her average transfer tax rate is 55 percent. The phaseout has the effect of creating a 60-percent marginal transfer tax rate on transfers in the phaseout range.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

Senate Amendment

The Senate amendment increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2006. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $625,000 for decedents dying and gifts made in 1998; $640,000 in 1999; $660,000 in 2000; $675,000 in 2001; $725,000 in 2002; $750,000 in 2003; $800,000 in 2004; $900,000 in 2005; and $1 million in 2006. After 2006, the effective exemption is indexed annually for inflation. The indexed exemption amount is rounded to the next lowest multiple of $10,000.

The Senate amendment includes the same conforming amendments as were made in the House bill.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

Conference Agreement

The conference agreement increases the present-law unified credit beginning in 1998, from an effective exemption of $600,000 to an effective exemption of $1,000,000 in 2006. The increase in the effective exemption is phased in according to the following schedule: the effective exemption is $625,000 for decedents dying and gifts made in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003; $850,000 in 2004; $950,000 in 2005; and $1 million in 2006 and thereafter. The conference does not index the effective exemption for inflation.

The conference agreement includes the conforming amendments made in the House bill and the Senate amendment.

Effective date.—The provision is effective for decedents dying, and gifts made, after December 31, 1997.

2. Indexing of certain other estate and gift tax provisions (sec. 501 (b)–(e) of the House bill and sec. 401 (b)–(e) of the Senate amendment)

Present Law

Annual exclusion for gifts.—A taxpayer may exclude $10,000 of gifts of present interests in property made by an individual ($20,000 per married couple) to each donee during a calendar year (sec. 2503).

Special use valuation.—An executor may elect for estate tax purposes to value certain qualified real property used in farming or a closely-held trade or business at its current use value, rather than its "highest and best use" value (sec. 2032A). The maximum reduction in value under such an election is $750,000.

Generation-skipping transfer ("GST") tax.—An individual 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.—An executor 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 (sec. 6166). The tax on the first $1,000,000 in value of a closely-held business is eligible for a special 4-percent interest rate (sec. 6601(j)).

House Bill

The House bill provides that, after 1998, the $10,000 annual exclusion for gifts, the $750,000 ceiling on special use valuation, the $1,000,000 generation-skipping transfer tax exemption, and the $1,000,000 ceiling on the value of a closely-held business eligible for the special low interest rate (as modified below), are indexed annually for inflation. Indexing of the annual exclusion is rounded to the next lowest multiple of $1,000 and indexing of the other amounts is rounded to the next lowest multiple of $10,000.

Effective date.—The proposal is effective for decedents dying, and gifts made, after December 31, 1998.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Estate tax exclusion for qualified family-owned businesses (sec. 402 of the Senate amendment)

Present Law

There are no special estate tax rules for qualified family-owned businesses. All taxpayers are allowed a unified credit in computing the taxpayer's estate and gift tax, which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax (sec. 2010). An executor also may elect, under section 2032A, 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 (up to a maximum reduction of $750,000). In addition, an executor may elect to pay the Federal estate tax attributable to a qualified closely-held business in installments over, at most, a 14-year period (sec. 6166). The tax attributable to the first $1,000,000 in value of a closely-held business is eligible for a special 4-percent interest rate (sec. 6601(j)).

House Bill

No provision.

Senate Amendment

The Senate amendment allows an executor to elect special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate and certain other requirements are met. In general, the provision excludes the first $1 million of value in qualified family-owned business interests from a decedent's taxable estate.

This new exclusion for qualified family-owned business interests is provided in addition to the unified credit (which currently effectively exempts $600,000 of taxable transfers from the estate and gift tax, and will be increased to an effective exemption of $1,000,000 of taxable transfers under other provisions of the Senate amendment), the special-use provisions of section 2032A (which permit the exclusion of up to $750,000 in value of a qualifying farm or other closely-held business from a decedent's estate), and the provisions of section 6166 (which provide for the installment payment of estate taxes attributable to closely held businesses).

Qualified family-owned business interests

For purposes of the provision, a qualified family-owned business interest is defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if ownership of the trade or business is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families, as long as the decedent's family owns at least 30 percent of the trade or business. Under the provision, members of an individual's family are defined using the same definition as is used for the special-use valuation rules of section 2032A, and thus include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants. For purposes of applying the ownership tests in the case of a corporation, the decedent and members of the decedent's family are required to own the requisite percentage of the total combined voting power of all classes of stock entitled to vote and the requisite percentage of the total value of all shares of all classes of stock of the corporation. In the case of a partnership, the decedent and members of the decedent's family are required to own the requisite percentage of the capital interest, and the requisite percentage of the profits interest, in the partnership.

In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules apply. Each trade or business owned (directly or indirectly) by the decedent and members of the decedent's family is separately tested to determine whether that trade or business meets the requirements of a qualified family-owned business interest. In applying these tests, any interest that a trade or business owns in another trade or business is disregarded in determining whether the first trade or business is a qualified family-owned business interest. The value of any qualified family-owned business interest held by an entity is treated as being proportionately owned by or for the entity's partners, shareholders, or beneficiaries. In the case of a multi-tiered entity, such rules are sequentially applied to look through each separate tier of the entity.

For example, if a holding company owns interests in two other companies, each of the three entities will be separately tested under the qualified family-owned business interest rules. In determining whether the holding company is a qualified family-owned business interest, its ownership interest in the other two companies is disregarded. Even if the holding company itself does not qualify as a family-owned business interest, the other two companies still may qualify if the direct and indirect interests held by the decedent and his or her family members satisfy the requisite ownership percentages and other requirements of a qualified family-owned business interest. If either (or both) of the lower-tier entities qualify, the value of the qualified family-owned business interests owned by the holding company are treated as proportionately owned by the holding company's shareholders.

An interest in a trade or business does not qualify if the business's (or a related entity's) stock or securities were publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in section 543). This personal holding company restriction does not apply to banks or domestic building and loan associations.

The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities. Under the provision, the value of qualified family-owned business interests does not include any cash or marketable securities in excess of the reasonably expected day-to-day working capital needs of the trade or business. For this purpose, it is intended that day-to-day working capital needs be determined based on a historical average of the business's working capital needs in the past, using an analysis similar to that set forth in *Bardahl Mfg. Corp.,* 24 T.C.M. 1030 (1965). It is further intended that accumulations for capital acquisitions not be considered "working capital" for this purpose. The value of the qualified family-owned business interests also does not include certain other passive assets. For this purpose, passive assets include any assets that: (1) produce dividends, interest, rents, royalties, annuities and certain other types of passive income (as described in sec. 543(a)); (2) are an interest in a trust, partnership or REMIC (as described in sec. 954(c)(1)(B)(ii)); (3) produce no income (as described in sec. 954(c)(1)(B)(iii)); (4) give rise to income from commodities transactions or foreign currency gains (as described in sec. 954(c)(1) (C) and (D)); (5) produce income equivalent to interest (as described in sec. 954(c)(1)(E)); or (6) produce income from notional principal contracts or payments in lieu of dividends (as described in new secs. 954(c)(1) (F) and (G), added elsewhere in the Senate amendment). In the case of a regular dealer in property, such property is not considered to produce passive income under these rules, and thus, is not considered to be a passive asset.

Qualifying estates

A decedent's estate qualifies for the special treatment only if the decedent was a U.S. citizen or resident at the time of death, and the aggregate value of the decedent's qualified family-owned business interests that are passed to qualified heirs exceeds 50 percent of the decedent's adjusted gross estate (the "50-percent liquidity test"). For this purpose, qualified heirs include any individual who has been actively employed by the trade or business for at least 10 years prior to the date of the decedent's death, and members of the decedent's family. If a qualified heir is not a citizen of the United States, any qualified family-owned business interest acquired by that heir must be held in a trust meeting requirements similar to those imposed on qualified domestic trusts (under present-law sec. 2056A(a)), or through certain other security arrangements that meet the satisfaction of the Treasury Secretary. The 50-percent liquidity test generally is applied by adding all transfers of qualified family-owned business interests made by the decedent to qualified heirs at the time of the decedent's death, plus certain lifetime gifts of qualified family-owned business interests made to members of the decedent's family, and comparing this total to the decedent's adjusted gross estate. To the extent that a decedent held qualified family-owned business interests in more than one trade or business, all such interests are aggregated for purposes of applying the 50-percent liquidity test.

The 50-percent liquidity test is calculated using a ratio, the numerator and denominator of which are described below.

The numerator is determined by aggregating the value of all qualified family-owned business interests that are includible in the decedent's gross estate and are passed from the decedent to a qualified heir, plus any lifetime transfers of qualified business interests that are made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family and were not otherwise includible in the decedent's gross estate. For this purpose, qualified business interests transferred to members of the decedent's family during the decedent's lifetime are valued as of the date of such transfer. This amount is then reduced by all indebtedness of the estate, except for the following: (1) indebtedness on a qualified residence of the decedent (determined in accordance with the requirements for deductibility of mortgage interest set forth in section 163(h)(3)); (2) indebtedness incurred to pay the educational or medical expenses of the decedent, the decedent's spouse or the decedent's dependents; and (3) other indebtedness of up to $10,000.

The denominator is equal to the decedent's gross estate, reduced by any indebtedness of the estate, and increased by the amount of the following transfers, to the extent not already included in the decedent's gross estate: (1) any lifetime transfers of qualified business interests that were made by the decedent to members of the decedent's family (other than the decedent's spouse), provided such interests have been continuously held by members of the decedent's family, plus (2) any other transfers from the decedent to the decedent's spouse that were made within 10 years of the date of the decedent's death, plus (3) any other transfers made by the decedent within three years of the decedent's death, except non-taxable transfers made to members of the decedent's family. The Secretary of Treasury is granted authority to disregard de minimis gifts. In determining the amount of gifts made by the decedent, any gift that the donor and the donor's spouse elected to have treated as a split gift (pursuant to sec. 2513) is treated as made one-half by each spouse for purposes of this provision.

Participation requirements

To qualify for the beneficial treatment provided under the Senate amendment, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) is required to materially participate in the trade or business for at least five years of any eight-year period within 10 years following the decedent's death. For this purpose, "material participation" is defined as under present-law section 2032A (special use valuation) and the regulations promulgated thereunder. See, e.g., Treas. Reg. sec. 20.2032A–3. Under such regulations, no one factor is determinative of the presence of material participation and the uniqueness of the particular industry (e.g., timber, farming, manufacturing, etc.) must be considered. Physical work and participation in management decisions are the principal factors to be considered. For example, an individual generally is considered to be materially participating in the business if he or she personally manages the business fully, regardless of the number of hours worked, as long as any necessary functions are performed.

If a qualified heir rents qualifying property to a member of the qualified heir's family on a net cash basis, and that family member materially participates in the business, the material participation requirement will be considered to have been met with respect to the qualified heir for purposes of this provision.

Recapture provisions

The benefit of the exclusions for qualified family-owned business interests are subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to meet the material participation requirements (i.e., if neither the qualified heir nor any member of his or her family has materially participated in the trade or business for at least five years of any eight-year period); (2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a conservation contribution under section 170(h); (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship. A qualified heir who loses U.S. citizenship may avoid such recapture by placing the qualified family-owned business assets into a trust meeting requirements similar to a qualified domestic trust (as described in present law sec. 2056A(a)), or through certain other security arrangements.

If one of the above recapture events occurs, an additional tax is imposed on the date of such event. As under section 2032A, each qualified heir is personally liable for the portion of the recapture tax that is imposed with respect to his or her interest in the qualified family-owned business. Thus, for example, if a brother and sister inherit a qualified family-owned business from their father, and only the sister materially participates in the business, her participation will cause both her and her brother to meet the material participation test. If she ceases to materially participate in the business within 10 years after her father's death (and the brother still does not materially participate), the sister and brother would both be liable for the recapture tax; that is, each would be liable for the recapture tax attributable to his or her interest.

The portion of the reduction in estate taxes that is recaptured would be dependent upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business after the decedent's death. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest is recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes is recaptured; if the participation was for at least seven years but less than eight years, 60 percent is recaptured; if the participation was for at least eight years but less than nine years, 40 percent is recaptured; and if the participation was for at least nine years but less than 10 years, 20 percent of the reduction in estate taxes is recaptured. In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under present-law section 2032A, however, the 10-year recapture period may be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

If a recapture event occurs with respect to any qualified family-owned business interest (or portion thereof), the amount of reduction in estate taxes attributable to that interest is determined on a proportionate basis. For example, if the decedent's estate included $2 million in qualified family-owned business interests and $1 million of such interests received beneficial treatment under this proposal, one-half of the value of the interest disposed of is deemed to have received the benefits provided under this proposal.

Effective date

The provision is effective with respect to the estates of decedents dying after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, except that the exclusion for family-owned business interests may be taken only to the extent that the exclusion for family-owned business interests, plus the amount effectively exempted by the unified credit, does not exceed $1.3 million.

The conferees clarify that a sale or disposition, in the ordinary course of business, of assets such as inventory or a piece of equipment used in the business (e.g., the sale of crops or a tractor) would not result in recapture of the benefits of the qualified family-owned business exclusion.

4. Reduction in estate tax for certain land subject to permanent conservation easement (sec. 403 of the Senate amendment)

Present Law

A deduction is allowed for estate and gift tax purposes for a contribution of a qualified real property interest to a charity (or other qualified organization) exclusively for conservation purposes (secs. 2055(f), 2522(d)). For this purpose, a qualified real property interest means the entire interest of the transferor in real property (other than certain mineral interests), a remainder interest in real property, or a perpetual restriction on the use of real property (sec. 170(h)). A "conservation purpose" is (1) preservation of land for outdoor recreation by, or the education of, the general public, (2) preservation of natural habitat, (3) preservation of open space for scenic enjoyment of the general public or pursuant to a governmental conservation policy, and (4) preservation of historically important land or certified historic structures. Also, a contribution will be treated as "exclusively for conservation purposes" only if the conservation purpose is protected in perpetuity.

A donor making a qualified conservation contribution generally is not allowed to retain an interest in minerals which may be extracted or removed by any surface mining method. However, deductions for contributions of conservation interests satisfying all of the above requirements will be permitted if two conditions are satisfied. First, the surface and mineral estates in the property with respect to which the contribution is made must have been separated before June 13, 1976 (and remain so separated) and, second, the probability of surface mining on the property with respect to which a contribution is made must be so remote as to be negligible (sec. 170(h)(5)(B)).

The same definition of qualified conservation contributions also applies for purposes of determining whether such contributions qualify as charitable deductions for income tax purposes.

House Bill

No provision.

Senate Amendment

Reduction in estate taxes for certain land subject to permanent conservation easement

The Senate amendment allows an executor to elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of sec.

170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Debt-financed property is not eligible for the exclusion.

The exclusion amount is calculated based on the value of the property after the conservation easement has been placed on the property. The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor, although payment for estate taxes on retained development rights may be deferred for up to two years, or until the disposition of the property, whichever is earlier. For this purpose, retained development rights are any rights retained to use the land for any commercial purpose which is not subordinate to and directly supportive of farming purposes, as defined in section 6420 (e.g., tree farming, ranching, viticulture, and the raising of other agricultural or horticultural commodities).

Maximum benefit allowed

The 40-percent estate tax exclusion for land subject to a qualified conservation easement (described above) may be taken only to the extent that the total exclusion for qualified conservation easements, plus the exclusion for qualified family-owned business interests (described in V.A.3., above), does not exceed $1 million. The executor of an estate holding land subject to a qualified conservation easement and/or qualified family-owned business interests is required to designate which of the two benefits is being claimed with respect to each property on which a benefit is claimed.

If the value of the conservation easement is less than 30 percent of (1) the value of the land without the easement, reduced by (2) the value of any retained development rights, then the exclusion percentage is reduced. The reduction in the exclusion percentage is equal to two percentage points for each point that the above ratio falls below 30 percent. Thus, for example, if the value of the easement is 25 percent of the value of the land before the easement less the value of the retained development rights, the exclusion percentage is 30 percent (i.e., the 40 percent amount is reduced by twice the difference between 30 percent and 25 percent). Under this calculation, if the value of the easement is 10 percent or less of the value of the land before the easement less the value of the retained development rights, the exclusion percentage is equal to zero.

Treatment of land subject to a conservation easement for purposes of special-use valuation

The granting of a qualified conservation easement (as defined above) is not treated as a disposition triggering the recapture provisions of section 2032A. In addition, the existence of a qualified conservation easement does not prevent such property from subsequently qualifying for special-use valuation treatment under section 2032A.

Retained mineral interests

The Senate amendment also allows a charitable deduction (for income tax purposes or estate tax purposes) to taxpayers making a contribution of a permanent conservation easement on property where a mineral interest has been retained and surface mining is possible, but its probability is "so remote as to be negligible." Present law provides for a charitable deduction in such a case if the mineral interests have been separated from the land prior to June 13, 1976. The provision allows such a charitable deduction to be taken regardless of when the mineral interests had been separated.

Effective date

The estate tax exclusion applies to decedents dying after December 31, 1997. The rules with respect to the treatment of conservation easements under section 2032A and with respect to retained mineral interests are effective for easements granted after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, except that the maximum exclusion for land subject to a qualified conservation easement is limited to $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter. The exclusion for land subject to a qualified conservation easement may be taken in addition to the maximum exclusion for qualified family-owned business interests (i.e., there is no coordination between the two provisions).

The conference agreement provides that de minimis commercial recreational activity that is consistent with the conservation purpose, such as the granting of hunting and fishing licenses, will not cause the property to fail to qualify under this provision. It is anticipated that the Secretary of the Treasury will provide guidance as to the definition of "de minimis" activities. In addition, the conference agreement makes technical modifications (a) to provide that the definition of farming for purposes of this provision is the same as the definition set forth in section 2032A(e)(5), and (b) to clarify that a post-mortem conservation easement may be placed on the property, as long as the easement has been made no later than the date of the election.

The conferees clarify that debt-financed property is eligible for this provision to the extent of the net equity in the property. For example, if a $1 million property is subject to an outstanding debt balance of $100,000, it is treated in the same manner as a $900,000 property that is not debt-financed.

5. Installment payments of estate tax attributable to closely held businesses (secs. 502–503 of the House bill and secs. 404–405 of the Senate amendment)

Present Law

In general, the Federal estate tax is due within nine months of a decedent's death. Under Code section 6166, an executor generally may elect to pay the estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period. If the election is made, the estate may pay only interest for the first four years, followed by up to 10 annual installments of principal and interest. Interest generally is imposed at the rate applicable to underpayments of tax under section 6621 (i.e., the Federal short-term rate plus 3 percentage points). Under 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.

To qualify for the installment payment election, the business must be an active trade or business and the value of the decedent's interest in the closely held business must exceed 35 percent of the decedent's adjusted gross estate. An interest in a closely held business includes: (1) any interest as a proprietor in a business carried on as a proprietorship; (2) any interest in a partnership carrying on a trade or business if the partnership has 15 or fewer partners, or if at least 20 percent of the partnership's assets are included in determining the decedent's gross estate; or (3) stock in a corporation if the corporation has 15 or fewer shareholders, or if at least 20 percent of the value of the voting stock is included in determining the decedent's gross estate.

House Bill

The House bill extends the period for which Federal estate tax installments can be made under section 6166 to a maximum period of 24 years. If the election is made, the estate pays only interest for the first four years, followed by up to 20 annual installments of principal and interest.

In addition, the House bill provides that no interest is imposed on the amount of deferred estate tax attributable to the first $1,000,000 in taxable value of the closely held business (i.e., the first $1,000,000 in value in excess of the effective exemption provided by the unified credit).

The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of the closely held business in excess of $1,000,000 is reduced to an amount equal to 45 percent of the rate applicable to underpayments of tax. The interest paid on estate taxes deferred under section 6166 is not deductible for estate or income tax purposes.

Effective date.—The provision is effective for decedents dying after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement reduces the 4-percent interest rate to 2 percent, and makes the interest paid on estate taxes deferred under section 6166 non-deductible for estate or income tax purposes. The 2-percent interest rate is imposed on the amount of deferred estate tax attributable to the first $1,000,000 in *taxable* value of the closely held business (i.e., the first $1,000,000 in value in excess of the effective exemption provided by the unified credit and any other exclusions).[55] The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of the closely held business in excess of $1,000,000 is reduced to an amount equal to 45 percent of the rate applicable to underpayments of tax.

The conference agreement does not include the provision that extends the repayment period to a maximum period of 24 years or the provision that provides a zero-percent interest rate for a portion of the deferred estate tax attributable to closely held businesses.

Effective date.—The provision is effective for decedents dying after December 31, 1997. Estates deferring estate tax under current law may make a one-time election to use the lower interest rates and forego the interest deduction for installments due after the date of the election (but such estates do not receive the benefit of the increase in the amount eligible for the 6601(j) interest rate—i.e., only the amount that was previously eligible for the 4-percent rate would be eligible for the 2-percent rate).

6. Estate tax recapture from cash leases of specially-valued property (sec. 504 of the House bill and sec. 406 of the Senate amendment)

Present Law

A Federal estate tax is imposed on the value of property passing at death. Generally, such property is included in the decedent's estate at its fair market value. Under section 2032A, the executor may elect to value certain "qualified real property" used in farming or other qualifying trade or business at its current use value rather than its highest and best use. If, after the special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special-use valuation (sec. 2032A(c)).

Some courts have held that cash rental of specially-valued property after the death of the decedent is not a qualified use under section 2032A because the heirs no longer bear the financial risk of working the property, and, therefore, results in the imposition of the additional estate tax under section 2032A(c). See *Martin* v. *Commissioner*, 783 F.2d 81 (7th Cir. 1986) (cash lease to unrelated party not qualified use); *Williamson* v. *Commissioner*, 93 T.C. 242 (1989), *aff'd*, 974 F.2d 1525 (9th Cir. 1992) (cash lease to family member not a qualified use); *Fisher* v. *Commissioner*, 65 T.C.M. 2284 (1993) (cash lease to family member not a qualified use); cf. *Minter* v. *U.S.*, 19 F.3d 426 (8th Cir. 1994) (cash lease to family's farming corporation is qualified use); Estate of *Gavin* v. *U.S.,* 1997 U.S. App. Lexis 10383 (8th Cir. 1997) (heir's option to pay cash rent or 50 percent crop share is qualified use).

With respect to a decedent's surviving spouse, a special rule provides that the surviving spouse will not be treated as failing to use the property in a qualified use solely because the spouse rents

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[55] The $1,000,000 threshold is indexed under other provisions of the bill.

the property to a member of the spouse's family on a net cash basis. (sec. 2032A(b)(5)). Under section 2032A, members of an individual's family include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants.

House Bill

The House bill provides that the cash lease of specially-valued real property by a lineal descendant of the decedent to a member of the lineal descendant's family, who continues to operate the farm or closely held business, does not cause the qualified use of such property to cease for purposes of imposing the additional estate tax under section 2032A(c).

Effective date.—The provision is effective for cash rentals occurring after December 31, 1976.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

7. Clarify eligibility for extension of time for payment of estate tax (sec. 505 of the House bill)

Present Law

In general, the Federal estate tax is due within nine months of a decedent's death. Under Code section 6166, an executor generally may elect to pay the estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period. If the election is made, the estate may pay only interest for the first four years, followed by up to 10 annual installments of principal and interest. To qualify for the installment payment election, the business must meet certain requirements. If certain events occur during the repayment period (e.g., the closely held business is sold), full payment of all deferred estate taxes is required at that time.

Under present law, there is limited access to judicial review of disputes regarding initial or continuing eligibility for the deferral and installment election under section 6166. If the Commissioner determines that an estate was not initially eligible for deferral under section 6166, or has lost its eligibility for such deferral, the estate is required to pay the full amount of estate taxes asserted by the Commissioner as being owed in order to obtain judicial review of the Commissioner's determination.

House Bill

The House bill authorizes the U.S. Tax Court to provide declaratory judgments regarding initial or continuing eligibility for deferral under section 6166.

Effective date.—The provision applies to decedents dying after date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Gifts may not be revalued for estate tax purposes after expiration of statute of limitations (sec. 506 of the House bill)

Present Law

The Federal estate and gift taxes are unified so that a single progressive rate schedule is applied to an individual's cumulative gifts and bequests. The tax on gifts made in a particular year is computed by determining the tax on the sum of the taxable gifts made that year and all prior years and then subtracting the tax on the prior years taxable gifts and the unified credit. Similarly, the estate tax is computed by determining the tax on the sum of the taxable estate and prior taxable gifts and then subtracting the tax on taxable gifts and the unified credit. Under a special rule applicable to the computation of the gift tax (sec. 2504(c)), the value of gifts made in prior years is the value that was used to determine the prior year's gift tax. There is no comparable rule in the case of the computation of the estate tax.

Generally, any estate or gift tax must be assessed within three years after the filing of the return. No proceeding in a court for the collection of an estate or gift tax can be begun without an assessment within the three-year period. If no return is filed, the tax may be assessed, or a suit commenced to collect the tax without assessment, at any time. If an estate or gift tax return is filed, and the amount of unreported items exceeds 25 percent of the amount of the reported items, the tax may be assessed or a suit commenced to collect the tax without assessment, within six years after the return was filed (sec. 6501).

Commencement of the statute of limitations generally does not require that a particular gift be disclosed. A special rule, however, applies to certain gifts that are valued under the special valuation rules of Chapter 14. The gift tax statute of limitations runs for such a gift only if it is disclosed on a gift tax return in a manner adequate to apprise the Secretary of the Treasury of the nature of the item.

Most courts have permitted the Commissioner to redetermine the value of a gift for which the statute of limitations period for the gift tax has expired in order to determine the appropriate tax rate bracket and unified credit for the estate tax. See, e.g., *Evanson* v. *United States,* 30 F.3d 960 (9th Cir. 1994); *Stalcup* v. *United States,* 946 F. 2d 1125 (5th Cir. 1991); *Estate of Levin,* 1991 T.C. Memo 1991–208, aff'd 986 F. 2d 91 (4th Cir. 1993); *Estate of Smith* v. *Commissioner,* 94 T.C. 872 (1990). But see *Boatman's First Na-*

tional Bank v. *United States,* 705 F. Supp. 1407 (W.D. Mo. 1988) (Commissioner not permitted to revalue gifts).

House Bill

The House bill provides that a gift for which the limitations period has passed cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit. For gifts made in calendar years after the date of enactment, the House bill also extends the special rule governing gifts valued under Chapter 14 to all gifts. Thus, the statute of limitations will not run on an inadequately disclosed transfer in calendar years after the date of enactment, regardless of whether a gift tax return was filed for other transfers in that same year.

It is intended that, in order to revalue a gift that has been adequately disclosed on a gift tax return, the IRS must issue a final notice of redetermination of value (a "final notice") within the statute of limitations applicable to the gift for gift tax purposes (generally, three years). This rule is applicable even where the value of the gift as shown on the return does not result in any gift tax being owed (e.g., through use of the unified credit). It also is anticipated that the IRS will develop an administrative appeals process whereby a taxpayer can challenge a redetermination of value by the IRS prior to issuance of a final notice.

A taxpayer who is mailed a final notice may challenge the redetermined value of the gift (as contained in the final notice) by filing a motion for a declaratory judgment with the Tax Court. The motion must be filed on or before 90 days from the date that the final notice was mailed. The statute of limitations is tolled during the pendency of the Tax Court proceeding.

Effective date.—The provision generally applies to gifts made after the date of enactment. The extension of the special rule under chapter 14 to all gifts applies to gifts made in calendar years after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

9. Repeal of throwback rules applicable to domestic trusts (sec. 507 of the House bill)

Present Law

A nongrantor trust is treated as a separate taxpayer for Federal income tax purposes. Such a trust generally is treated as a conduit with respect to amounts distributed currently[56] and taxed with respect to any income which is accumulated in the trust rather than distributed. A separate graduated tax rate structure applies to trusts which historically has permitted accumulated trust

[56] The conduit treatment is achieved by allowing the trust a deduction for amounts distributed to beneficiaries during the taxable year to the extent of distributable net income and by including such distributions in the beneficiaries' income.

income to be taxed at lower rates than the rates applicable to trust beneficiaries. This benefit often was compounded through the creation of multiple trusts.

The Internal Revenue Code has several rules intended to limit the benefit that would otherwise occur from using the lower rates applicable to one or more trusts. Under the so-called "throwback" rules, the distribution of previously accumulated trust income to a beneficiary will be subject to tax (in addition to any tax paid by the trust on that income) where the beneficiary's average top marginal rate in the previous five years is higher than those of the trust.

Under section 643(f), two or more trusts are treated as one trust if (1) the trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and (2) a principal purpose for the existence of the trusts is to avoid Federal income tax. For trusts that were irrevocable as of March 1, 1984, section 643(f) applies only to contributions to corpus after that date.

Under section 644, if property is sold within two years of its contribution to a trust, the gain that would have been recognized had the contributor sold the property is taxed at the contributor's marginal tax rates. In effect, section 644 treats such gains as if the contributor had realized the gain and then transferred the net after-tax proceeds from the sale to the trust as corpus.

Sections 665 through 668 apply different rules to distributions of previously accumulated trust income from a foreign trust than to distributions of such income from domestic trusts. If a foreign trust accumulates income, changes its situs so as to become a domestic trust, and then makes a distribution that is deemed to have been made in a year in which the trust was a foreign trust, the distribution is treated as a distribution from a foreign trust for purposes of the accumulation distribution rules. Rev. Rul. 91–6, 1991–1 C.B. 89.

House Bill

The House bill exempts from the throwback rules amounts distributed by a domestic trust after the date of enactment. The House bill also provides that precontribution gain on property sold by a domestic trust no longer is subject to section 644 (i.e., taxed at the contributor's marginal tax rates).

The treatment of foreign trusts, including the treatment of foreign trusts that become domestic trusts,[57] remains unchanged.

Effective date.—The provision with respect to the throwback rules is effective for distributions made in taxable years beginning after the date of enactment. The modification to section 644 applies to sales or exchanges after the date of enactment.

Senate Amendment

No provision.

[57] Rev. Rul. 91–6, 1991–1 C.B. 89.

Conference Agreement

The conference agreement follows the House bill, except that the throwback rules continue to apply with respect to (a) foreign trusts, (b) domestic trusts that were once treated as foreign trusts (except as provided in Treasury regulations), and (c) domestic trusts created before March 1, 1984, that would be treated as multiple trusts under sec. 643(f) of the Code.

10. Unified credit of decedent increased by unified credit of spouse used on split gift included in decedent's gross estate (sec. 508 of the House bill)

Present Law

A gift tax is imposed on transfers by gift during life and an estate tax is imposed on transfers at death. The gift and estate taxes are a unified transfer tax system in that one progressive tax is imposed on the cumulative transfers during lifetime and at death. The first $10,000 of gifts of present interests to each donee during any one calendar year are excluded from Federal gift tax. Under section 2513, one spouse can elect to treat a gift made by the other spouse to a third person as made one-half by each spouse (i.e., "gift-splitting").

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 and then subtracting any transfer taxes payable for prior taxable periods. This amount is reduced by any remaining available unified credit (and other applicable credits) to determine the estate tax liability. The estate tax is imposed on all of the assets held by the decedent at his death, including the value of certain property previously transferred by the decedent in which the decedent had certain retained powers or interests. In such circumstances, property that has been treated as a gift made one-half by each spouse may be includible in both spouses' estates.

House Bill

With respect to any split-gift property that is subsequently includible in both spouses' estates, the House bill increases the unified credit allowable to the decedent's estate by the amount of the unified credit previously allowed to the decedent's spouse with respect to the split gift.

Effective date.—The provision applies to gifts made after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

11. Reformation of defective bequests to spouse of decedent (sec. 509 of the House bill)

Present Law

A "marital deduction" generally is allowed for estate and gift tax purposes for the value of property passing to a spouse. However, "terminable interest" property (i.e., an interest in property that will terminate or fail) transferred to a spouse generally will only qualify for the marital deduction under certain special rules designed to ensure that there will be an estate or gift tax to the transferee spouse on unspent transferred proceeds. Thus, the effect of a marital deduction with the terminable interest rule is to provide only a method of deferral of the estate or gift tax, not exemption. One of the special terminable interest rules (Code sec. 2056(b)(5)) provides that the marital deduction is allowed where the decedent transfers property to a trust that is required to pay income to the surviving spouse and the surviving spouse has a general power of appointment at that spouse's death (under this so-called "power of appointment trust," the power of appointment both provides the surviving spouse with power to control the ultimate disposition of the trust assets and assures that the trust assets will be subject to estate or gift tax). Another special terminable interest rule called the "qualified terminable interest property" rule ("QTIP") generally permits a marital deduction for transfers by the decedent to a trust that is required to distribute all of the income to the surviving spouse at least annually and an election is made to subject the transferee spouse to transfer tax on the trust property. To qualify for the marital deduction, a power of appointment trust or QTIP trust must meet certain specific requirements. If there is a technical defect in meeting those requirements, the marital deduction may be lost.

House Bill

The House bill allows the marital deduction with respect to a defective power of appointment or QTIP trust if there is a "qualified reformation" of the trust that corrects the defect. In order to qualify, the reformation must change the governing instrument in a manner that cures the defects to qualification of the trust for the marital deduction. In addition, where a reformation proceeding is commenced after the due date for the estate tax return (including extensions), the reformation would qualify only if, prior to reformation, the governing instrument provides (1) that the surviving spouse is entitled to all of the income from the property for life, and (2) no person other than the surviving spouse is entitled to any distributions during the surviving spouse's life. With respect to QTIP, an election to qualify must be made by the executor on the estate tax return as required by section 2056(b)(7)(B)(v).

The determination of whether a marital deduction should be allowed (i.e., the reformation has cured the defects to qualification and otherwise qualifies under this provision) is made either as of the due date for filing the estate or gift tax return (including any extensions) or the time that changes are completed pursuant to a reformation proceeding. The statute of limitations is extended with respect to the estate or gift tax attributable to the trust property until one year after the date the Treasury Department is notified that a qualified reformation has been completed or that the reformation proceeding has otherwise terminated.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

B. Generation-Skipping Tax Provisions

1. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 511 of the House bill)

Present Law

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 more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations and taxable distributions. An exemption of $1 million is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property.

If the value of the transferred property exceeds the amount of the GST exemption allocated to that property, the GST tax generally is determined by multiplying a flat tax rate equal to the highest estate tax rate (i.e., currently 55 percent) by the "inclusion percentage" and the value of the taxable property at the time of the taxable event. The "inclusion percentage" is the number one minus the "exclusion percentage". The exclusion percentage generally is calculated by dividing the amount of the GST exemption allocated to the property by the value of the property.

Under Treasury regulations, trusts that are included in the transferor's gross estate or created under the transferor's will may be validly severed only if (1) the trust is severed according to a direction in the governing instrument; or (2) the trust is severed pursuant to the trustee's discretionary powers, but only if certain other conditions are satisfied (e.g., the severance occurs or a reformation proceeding begins before the estate tax return is due). Treas. Reg. 26.2654–1(b).

House Bill

If a trust with an inclusion ratio of greater than zero is severed into two separate trusts, the House bill allows the trustee to elect to treat one of the separate trusts as having an inclusion ratio of zero and the other separate trust as having an inclusion ratio of one. To qualify for this treatment, the separate trust with the inclusion ratio of one must receive an interest in each property held by the single trust (prior to severance) equal to the single trust's inclusion ratio, except to the extent otherwise provided by regulation. The remaining interests in each property will be transferred to the separate trust with the inclusion ratio of zero. The election must be irrevocable, and must be made at a time and in a manner prescribed by the Treasury Department.

Effective date.—The provision is effective for severances of trusts occurring after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

2. Modification of generation-skipping transfer tax for transfers to individuals with deceased parents (sec. 512 of the House bill and sec. 407 of the Senate amendment)

Present Law

Under the "predeceased parent exception", a direct skip transfer to a transferor's grandchild is not subject to the generation-skipping transfer ("GST") tax if the child of the transferor who was the grandchild's parent is deceased at the time of the transfer (sec. 2612(c)(2)). This "predeceased parent exception" to the GST tax is not applicable to (1) transfers to collateral heirs, e.g., grandnieces or grandnephews, or (2) taxable terminations or taxable distributions.

House Bill

The House bill extends the predeceased parent exception to transfers to collateral heirs, provided that the decedent has no living lineal descendants at the time of the transfer. For example, the exception would apply to a transfer made by an individual (with no living lineal heirs) to a grandniece where the transferor's nephew or niece who is the parent of the grandniece is deceased at the time of the transfer.

In addition, the House bill extends the predeceased parent exception (as modified by the change in the preceding paragraph) to taxable terminations and taxable distributions, provided that the parent of the relevant beneficiary was dead at the earliest time that the transfer (from which the beneficiary's interest in the property was established) was subject to estate or gift tax. For example, where a trust was established to pay an annuity to a charity for a term for years with a remainder interest granted to a grandson, the termination of the term for years would not be a taxable termination subject to the GST tax if the grandson's parent (who is the son or daughter of the transferor) is deceased at the time the trust was created and the transfer creating the trust was subject to estate or gift tax.

Effective date.—The provision is effective for generation skipping transfers occurring after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

VI. EXTENSION OF CERTAIN EXPIRING TAX PROVISIONS

A. Research Tax Credit (sec. 601 of the House bill and sec. 501 of the Senate amendment)

Present Law

General rule

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit expired and generally will not apply to amounts paid or incurred after May 31, 1997.[1]

A 20-percent research tax credit also applied to the excess of (1) 100 percent of corporate cash expenditures (including grants or contributions) paid for basic research conducted by universities (and certain nonprofit scientific research organizations) over (2) the sum of (a) the greater of two minimum basic research floors plus (b) an amount reflecting any decrease in nonresearch giving to universities by the corporation as compared to such giving during a fixed-base period, as adjusted for inflation. This separate credit computation is commonly referred to as the "university basic research credit" (see sec. 41(e)).

Computation of allowable credit

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum ratio of .16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3 percent.[2]

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[1] When originally enacted, the research tax credit applied to qualified expenses incurred after June 30, 1981. The credit was modified several times and was extended through June 30, 1995. The credit later was extended for the period July 1, 1996, through May 31, 1997 (with a special 11-month extension for taxpayers that elect to be subject to the alternative incremental research credit regime).

[2] The Small Business Job Protection Act of 1996 expanded the definition of "start-up firms" under section 41(c)(3)(B)(I) to include any firm if the first taxable year in which such firm had both gross receipts and qualified research expenses began after 1983.

A special rule (enacted in 1993) is designed to gradually recompute a start-up firm's fixed-base percentage based on its actual research experience. Under this special rule, a start-up firm

Continued

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

To prevent artificial increases in research expenditures by shifting expenditures among commonly controlled or otherwise related entities, a special aggregation rule provides that all members of the same controlled group of corporations are treated as a single taxpayer (sec. 41(f)(1)). Special rules apply for computing the credit when a major portion of a business changes hands, under which qualified research expenditures and gross receipts for periods prior to the change of ownership of a trade or business are treated as transferred with the trade or business that gave rise to those expenditures and receipts for purposes of recomputing a taxpayer's fixed-base percentage (sec. 41(f)(3)).

Alternative incremental research credit regime

As part of the Small Business Job Protection Act of 1996, taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 1.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1 percent (i.e., the base amount equals 1 percent of the taxpayer's average gross receipts for the four preceding years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 2.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2 percent. A credit rate of 2.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2 percent. An election to be subject to this alternative incremental credit regime may be made only for a taxpayer's first taxable year beginning after June 30, 1996, and before July 1, 1997, and such an election applies to that taxable year and all subsequent years (in the event that the credit subsequently is extended by Congress) unless revoked with the consent of the Secretary of the Treasury. If a taxpayer elects the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, then all qualified research expenses paid or incurred during the first 11 months of such taxable year are treated as qualified research expenses for purposes of computing the taxpayer's credit.

will be assigned a fixed-base percentage of 3 percent for each of its first five taxable years after 1993 in which it incurs qualified research expenditures. In the event that the research credit is extended beyond the scheduled expiration date, a start-up firm's fixed-base percentage for its sixth through tenth taxable years after 1993 in which it incurs qualified research expenditures will be a phased-in ratio based on its actual research experience. For all subsequent taxable years, the taxpayer's fixed-base percentage will be its actual ratio of qualified research expenditures to gross receipts for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993 (sec. 41(c)(3)(B)).

Eligible expenditures

Qualified research expenditures eligible for the research tax credit consist of: (1) "in-house" expenses of the taxpayer for wages and supplies attributable to qualified research; (2) certain time-sharing costs for computer use in qualified research; and (3) 65 percent of amounts paid by the taxpayer for qualified research conducted on the taxpayer's behalf (so-called "contract research expenses").[3]

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 (described below) but must be undertaken for the purpose of discovering information that is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must pertain to functional aspects, performance, reliability, or quality of a business component. Research does not qualify for the credit if substantially all of the activities relate to style, taste, cosmetic, or seasonal design factors (sec. 41(d)(3)). In addition, research does not qualify for the credit if conducted after the beginning of commercial production of the business component, if related to the adaptation of an existing business component to a particular customer's requirements, if related to the duplication of an existing business component from a physical examination of the component itself or certain other information, or if related to certain efficiency surveys, market research or development, or routine quality control (sec. 41(d)(4)).

Expenditures attributable to research that is conducted outside the United States do not enter into the credit computation. In addition, the credit is not available for research in the social sciences, arts, or humanities, nor is it available for research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity).

Relation to deduction

Under section 174, taxpayers may elect to deduct currently the amount of certain research or experimental expenditures incurred in connection with a trade or business, notwithstanding the general rule that business expenses to develop or create an asset that has a useful life extending beyond the current year must be capitalized. However, deductions allowed to a taxpayer under section 174 (or any other section) are reduced by an amount equal to 100 percent of the taxpayer's research tax credit determined for the taxable year. Taxpayers may alternatively elect to claim a reduced research tax credit amount under section 41 in lieu of reducing deductions otherwise allowed (sec. 280C(c)(3)).

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[3] Under a special rule enacted as part of the Small Business Job Protection Act of 1996, 75 percent of amounts paid to a research consortium for qualified research is treated as qualified research expenses eligible for the research credit (rather than 65 percent under the general rule under section 41(b)(3) governing contract research expenses) if (1) such research consortium is a tax-exempt organization that is described in section 501(c)(3) (other than a private foundation) or section 501(c)(6) and is organized and operated primarily to conduct scientific research, and (2) such qualified research is conducted by the consortium on behalf of the taxpayer and one or more persons not related to the taxpayer.

House Bill

The research tax credit is extended for 19 months—i.e., generally for the period June 1, 1997, through December 31, 1998.

Under the House bill, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through December 31, 1998. A special rule provides that, notwithstanding the general termination date for the research credit of December 31, 1998, if a taxpayer elects to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 30-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 plus an additional 19-month extension provided for by this bill. However, to prevent taxpayers from effectively obtaining more than 30 months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 30-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

Senate Amendment

The research tax credit is extended for 24 months—i.e., generally for the period June 1, 1997, through May 31, 1999.

Under the Senate amendment, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through December 31, 1999. A special rule provides that, notwithstanding the general termination date for the research credit of December 31, 1999, if a taxpayer elects to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 35-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 plus an additional 24-month extension provided for by the Senate amendment. However, to prevent taxpayers from effectively obtaining more than 35 months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 35-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

Conference Agreement

Under the conference agreement, the research tax credit is extended for 13 months—i.e., generally for the period June 1, 1997, through June 30, 1998.

Under the provision, taxpayers are permitted to elect the alternative incremental research credit regime under section 41(c)(4) for any taxable year beginning after June 30, 1996, and such election will apply to that taxable year and all subsequent taxable years unless revoked with the consent of the Secretary of the Treasury.

Effective date.—The provision generally is effective for qualified research expenditures paid or incurred during the period June 1, 1997, through June 30, 1998. A special rule provides that, notwithstanding the general termination date for the research credit of June 30, 1998, if a taxpayer elects to be subject to the alternative incremental research credit regime for its first taxable year beginning after June 30, 1996, and before July 1, 1997, the alternative incremental research credit will be available during the entire 24-month period beginning with the first month of such taxable year—i.e., the equivalent of the 11-month extension provided for by the Small Business Job Protection Act of 1996 plus an additional 13-month extension provided for by the conference agreement. However, to prevent taxpayers from effectively obtaining more than 24 months of research credits from the Small Business Job Protection Act of 1996 and this bill, the 24-month period for taxpayers electing the alternative incremental research credit regime is reduced by the number of months (if any) after June 1996 with respect to which the taxpayer claimed research credit amounts under the regular, 20-percent research credit rules.

B. Contributions of Stock to Private Foundations (sec. 602 of the House bill and sec. 502 of the Senate amendment)

Present Law

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the fair market value of property contributed to a charitable organization.[4] However, in the case of a charitable contribution of short-term gain, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the

[4] The amount of the deduction allowable for a taxable year with respect to a charitable contribution may be reduced depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)).

recipient charitable organization is unrelated to the organization's tax-exempt purpose.[5]

In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property. However, under a special rule contained in section 170(e)(5), taxpayers are allowed a deduction equal to the fair market value of "qualified appreciated stock" contributed to a private foundation prior to May 31, 1997.[6] Qualified appreciated stock is defined as publicly traded stock which is capital gain property. The fair-market-value deduction for qualified appreciated stock donations applies only to the extent that total donations made by the donor to private foundations of stock in a particular corporation did not exceed 10 percent of the outstanding stock of that corporation. For this purpose, an individual is treated as making all contributions that were made by any member of the individual's family.

House Bill

The House bill extends the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations during the period June 1, 1997, through December 31, 1998.

Effective date.—The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through December 31, 1998.

Senate Amendment

The Senate amendment extends the special rule contained in section 170(e)(5) for contributions of qualified appreciated stock made to private foundations during the period June 1, 1997, through May 31, 1999.

Effective date.—The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through May 31, 1999.

Conference Agreement

The conference agreement provides that the special rule contained in section 170(e)(5) is extended for the period June 1, 1997, through June 30, 1998. The provision is effective for contributions of qualified appreciated stock to private foundations made during the period June 1, 1997, through June 30, 1998.

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[5] As part of the Omnibus Budget Reconciliation Act of 1993, Congress eliminated the treatment of contributions of appreciated property (real, personal, and intangible) as a tax preference for alternative minimum tax (AMT) purposes. Thus, if a taxpayer makes a gift to charity of property (other than short-term gain, inventory, or other ordinary income property, or gifts to private foundations) that is real property, intangible property, or tangible personal property, the use of which is related to the donee's tax-exempt purpose, the taxpayer is allowed to claim the same fair-market-value deduction for both regular tax and AMT purposes (subject to present-law percentage limitations).

[6] The special rule contained in section 170(e)(5), which was originally enacted in 1984, expired January 1, 1995. The Small Business Job Protection Act of 1996 reinstated the rule for 11 months—for contributions of qualified appreciated stock made to private foundations during the period July 1, 1996, through May 31, 1997.

C. Work Opportunity Tax Credit (sec. 603 of the House bill and sec. 503 of the Senate amendment)

Present Law

In general

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of seven targeted groups. The credit generally is equal to 35 percent of qualified wages. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer.

Generally, no more than $6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual is $2,100. With respect to qualified summer youth employees, the maximum credit is 35 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,050.

The deduction for wages is reduced by the amount of the credit.

Targeted groups eligible for the credit

(1) Families receiving AFDC

An eligible recipient is an individual certified by the designated local employment agency as being a member of a family eligible to receive benefits under AFDC or its successor program for a period of at least nine months part of which is during the 9-month period ending on the hiring date. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for the AFDC or its successor program.

(2) Qualified ex-felon

A qualified ex-felon is an individual certified as: (1) having been convicted of a felony under any State or Federal law, (2) being a member of a family that had an income during the six months before the earlier of the date of determination or the hiring date which on an annual basis is 70 percent or less of the Bureau of Labor Statistics lower living standard, and (3) having a hiring date within one year of release from prison or date of conviction.

(3) High-risk youth

A high-risk youth is an individual certified as being at least 18 but not yet 25 on the hiring date and as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). Qualified wages will not include wages paid or incurred for services performed after the individual moves outside an empowerment zone or enterprise community.

(4) Vocational rehabilitation referral

Vocational rehabilitation referrals are those individuals who have a physical or mental disability that constitutes a substantial handicap to employment and who have been referred to the employer while receiving, or after completing, vocational rehabilitation services under an individualized, written rehabilitation plan under a State plan approved under the Rehabilitation Act of 1973 or under a rehabilitation plan for veterans carried out under Chapter 31 of Title 38, U.S. Code. Certification will be provided by the designated local employment agency upon assurances from the vocational rehabilitation agency that the employee has met the above conditions.

(5) Qualified summer youth employee

Qualified summer youth employees are individuals: (1) who perform services during any 90-day period between May 1 and September 15, (2) who are certified by the designated local agency as being 16 or 17 years of age on the hiring date, (3) who have not been an employee of that employer before, and (4) who are certified by the designated local agency as having a principal place of abode within an empowerment zone or enterprise community (as defined under Subchapter U of the Internal Revenue Code). As with high-risk youths, no credit is available on wages paid or incurred for service performed after the qualified summer youth moves outside of an empowerment zone or enterprise community. If, after the end of the 90-day period, the employer continues to employ a youth who was certified during the 90-day period as a member of another targeted group, the limit on qualified first-year wages will take into account wages paid to the youth while a qualified summer youth employee.

(6) Qualified veteran

A qualified veteran is a veteran who is a member of a family certified as receiving assistance under: (1) AFDC for a period of at least nine months part of which is during the 12-month period ending on the hiring date, or (2) a food stamp program under the Food Stamp Act of 1977 for a period of at least three months part of which is during the 12-month period ending on the hiring date. For these purposes, members of a family are defined to include only those individuals taken into account for purposes of determining eligibility for: (i) the AFDC or its successor program, and (ii) a food stamp program under the Food Stamp Act of 1977, respectively.

Further, a qualified veteran is an individual who has served on active duty (other than for training) in the Armed Forces for more than 180 days or who has been discharged or released from active duty in the Armed Forces for a service-connected disability. However, any individual who has served for a period of more than 90 days during which the individual was on active duty (other than for training) is not an eligible employee if any of this active duty occurred during the 60-day period ending on the date the individual was hired by the employer. This latter rule is intended to prevent employers who hire current members of the armed services (or those departed from service within the last 60 days) from receiving the credit.

(7) Families receiving food stamps

An eligible recipient is an individual aged 18 but not yet 25 certified by a designated local employment agency as being a member of a family receiving assistance under a food stamp program under the Food Stamp Act of 1977 for a period of at least six months ending on the hiring date. In the case of families that cease to be eligible for food stamps under section 6(o) of the Food Stamp Act of 1977, the six-month requirement is replaced with a requirement that the family has been receiving food stamps for at least three of the five months ending on the date of hire. For these purposes, members of the family are defined to include only those individuals taken into account for purposes of determining eligibility for a food stamp program under the Food Stamp Act of 1977.

Minimum employment period

No credit is allowed for wages paid unless the eligible individual is employed by the employer for at least 180 days (20 days in the case of a qualified summer youth employee) or 400 hours (120 hours in the case of a qualified summer youth employee).

Expiration date

The credit is effective for wages paid or incurred to a qualified individual who begins work for an employer after September 30, 1996, and before October 1, 1997.

House Bill

Extension

The House bill provides a one-year extension of the work opportunity tax credit.

Targeted categories

The bill extends eligibility to members of families receiving AFDC benefits for any nine months during the eighteen month period ending on the hiring date.

Minimum employment period

The minimum employment period is reduced from 400 to 120 hours.

Credit percentage

The House bill provides a credit percentage of 25 percent for employment of less than 400 hours of employment and 40 percent for employment of 400 or more hours.

Alternative minimum tax (AMT)

The House bill allows the credit against the AMT.

Effective date

Generally, the provision is effective for wages paid or incurred to qualified individuals who begin work for the employer after September 30, 1997, and before October 1, 1998. The provision allowing the credit against the AMT is effective for taxable years beginning after December 31, 1997.

Senate Amendment

Extension

The Senate amendment provides a 20-month extension of the work opportunity tax credit.

Targeted categories

Same as the House bill, except the Senate amendment adds SSI beneficiaries as a new category of workers for which the credit is available.

Minimum employment period

Same as the House bill.

Credit percentage

Same as the House bill.

Alternative minimum tax (AMT)

No provision.

Effective date

The provision is effective for wages paid or incurred to qualified individuals who begin work for the employer after September 30, 1997, and before June 1, 1999.

Conference Agreement

Extension

The conference agreement provides for a 9-month extension of the work opportunity tax credit.

Targeted categories

The conference agreement follows the Senate amendment.

Minimum employment period

The conference agreement follows the House bill and the Senate amendment.

Credit percentage

The conference agreement follows the House bill and the Senate amendment.

Alternative minimum tax (AMT)

The conference agreement does not include the House bill provision.

Effective date

The conference agreement is generally effective for wages paid to qualified individuals who begin work for an employer after September 30, 1997, and before July 1, 1998.

D. Orphan Drug Tax Credit (sec. 604 of the House bill and sec. 504 of the Senate amendment)

Present Law

A 50-percent nonrefundable tax credit is allowed for qualified clinical testing expenses incurred in testing of certain drugs for rare diseases or conditions, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration ("FDA") but before the drug has been approved for sale by the FDA. A rare disease or condition is defined as one that (1) affects less than 200,000 persons in the United States, or (2) affects more than 200,000 persons, but for which there is no reasonable expectation that businesses could recoup the costs of developing a drug for such disease or condition from U.S. sales of the drug. These rare diseases and conditions include Huntington's disease, myoclonus, ALS (Lou Gehrig's disease), Tourette's syndrome, and Duchenne's dystrophy (a form of muscular dystrophy).

As with other general business credits (sec. 38), taxpayers are allowed to carry back unused credits to three years preceding the year the credit is earned (but not to a taxable year ending before July 1, 1996) and to carry forward unused credits to 15 years following the year the credit is earned. The credit cannot be used to offset a taxpayer's alternative minimum tax liability.

The orphan drug tax credit expired and does not apply to expenses paid or incurred after May 31, 1997.[7]

House Bill

The orphan drug tax credit provided for by section 45C is permanently extended.

Effective date.—The provision is effective for qualified clinical testing expenses paid or incurred after May 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment—i.e., the orphan drug tax credit is permanently extended.

[7] The orphan drug tax credit originally was enacted in 1983 and was extended on several occasions. The credit expired on December 31, 1994, and later was reinstated for the period July 1, 1996, through May 31, 1997.

VII. DISTRICT OF COLUMBIA TAX INCENTIVES

(secs. 701–702 of the House bill and sec. 601 of the Senate amendment)

Present Law

Empowerment zones and enterprise communities

In general

Pursuant to the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), the Secretaries of the Department of Housing and Urban Development (HUD) and the Department of Agriculture designated a total of nine empowerment zones and 95 enterprise communities on December 21, 1994. As required by law, six empowerment zones are located in urban areas (with aggregate population for the six designated urban empowerment zones limited to 750,000) and three empowerment zones are located in rural areas.[8] Of the enterprise communities, 65 are located in urban areas and 30 are located in rural areas (sec. 1391). Designated empowerment zones and enterprise communities were required to satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations (sec. 1392). Portions of the District of Columbia were designated as an enterprise community.

The following tax incentives are available for certain businesses located in empowerment zones: (1) an annual 20-percent wage credit for the first $15,000 of wages paid to a zone resident who works in the zone; (2) an additional $20,000 of expensing under Code section 179 for "qualified zone property" placed in service by an "enterprise zone business" (accordingly, certain businesses operating in empowerment zones are allowed up to $38,000 of expensing for 1997; the allowable amount will increase to $38,500 for 1998); and (3) special tax-exempt financing for certain zone facilities (described in more detail below).

The 95 enterprise communities are eligible for the special tax-exempt financing benefits but not the other tax incentives available in the nine empowerment zones. In addition to these tax incentives, OBRA 1993 provided that Federal grants would be made to designated empowerment zones and enterprise communities.

The tax incentives for empowerment zones and enterprise communities generally will be available during the period that the designation remains in effect, i.e., a 10-year period.

[8] The six designated urban empowerment zones are located in New York City, Chicago, Atlanta, Detroit, Baltimore, and Philadelphia-Camden (New Jersey). The three designated rural empowerment zones are located in Kentucky Highlands (Clinton, Jackson, and Wayne counties, Kentucky), Mid-Delta Mississippi (Bolivar, Holmes, Humphreys, Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

Definition of "qualified zone property"

Present-law section 1397C defines "qualified zone property" as depreciable tangible property (including buildings), provided that: (1) the property is acquired by the taxpayer (from an unrelated party) after the zone or community designation took effect; (2) the original use of the property in the zone or community commences with the taxpayer; and (3) substantially all of the use of the property is in the zone or community in the active conduct of a trade or business by the taxpayer in the zone or community. In the case of property which is substantially renovated by the taxpayer, however, the property need not be acquired by the taxpayer after zone or community designation or originally used by the taxpayer within the zone or community if, during any 24-month period after zone or community designation, the additions to the taxpayer's basis in the property exceed the greater of 100 percent of the taxpayer's basis in the property at the beginning of the period, or $5,000.

Definition of "enterprise zone business"

Present-law section 1397B defines the term "enterprise zone business" as a corporation or partnership (or proprietorship) if for the taxable year: (1) the sole trade or business of the corporation or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community; (2) at least 80 percent of the total gross income is derived from the active conduct of a "qualified business" within a zone or community; (3) substantially all of the business's tangible property is used within a zone or community; (4) substantially all of the business's intangible property is used in, and exclusively related to, the active conduct of such business; (5) substantially all of the services performed by employees are performed within a zone or community; (6) at least 35 percent of the employees are residents of the zone or community; and (7) no more than 5 percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.

A "qualified business" is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license.[9] In addition, the leasing of real property that is located within the empowerment zone or community to others is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property to others is not a qualified business unless substantially all of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone or enterprise community.

Tax-exempt financing rules

Tax-exempt private activity bonds may be issued to finance certain facilities in empowerment zones and enterprise commu-

[9] Also, a qualified business does not include certain facilities described in section 144(c)(6)(B) (e.g., massage parlor, hot tub facility, or liquor store) or certain large farms.

nities. These bonds, along with most private activity bonds, are subject to an annual private activity bond State volume cap equal to $50 per resident of each State, or (if greater) $150 million per State.

Qualified enterprise zone facility bonds are bonds 95 percent or more of the net proceeds of which are used to finance (1) "qualified zone property" (as defined above) the principal user of which is an "enterprise zone business" (also defined above [10]), or (2) functionally related and subordinate land located in the empowerment zone or enterprise community. These bonds may only be issued while an empowerment zone or enterprise community designation is in effect.

The aggregate face amount of all qualified enterprise zone bonds for each qualified enterprise zone business may not exceed $3 million per zone or community. In addition, total qualified enterprise zone bond financing for each principal user of these bonds may not exceed $20 million for all zones and communities.

Taxation of capital gains

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 generally is taxed at the same rate as ordinary income, except that the maximum rate of tax is limited to 28 percent of the net capital gain.[11] 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.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct capital losses against up to $3,000 of ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable 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, and (5) certain publications of the Federal Government.

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 generally is 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.

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[10] For purposes of the tax-exempt financing rules, an "enterprise zone business" also includes a business located in a zone or community which would qualify as an enterprise zone business if it were separately incorporated.

[11] The Revenue Reconciliation Act of 1993 added Code section 1202, which provides 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.

Individual tax rates

To determine tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status. For 1997, the individual income tax rate schedules are as follows:

If taxable income is—	Then income tax equals
	Single individuals
$0 to $24,650	15 percent of taxable income
$24,651 to $59,750 ..	$3,698, plus 28% of the amount over $24,650
$59,751 to $124,650	$13,526, plus 31% of the amount over $59,750
$124,651 to $271,050	$33,645, plus 36% of the amount over $124,650
Over $271,050	$86,349, plus 39.6% of the amount over $271,050
	Heads of households
$0 to $33,050	15 percent of taxable income
$33,051 to $85,350 ..	$4,958, plus 28% of the amount over $33,050
$85,351 to $138,200	$19,602 plus 31% of the amount over $85,350
$138,201 to $271,050	$35,985, plus 36% of the amount over $138,200
Over $271,050	$83,811, plus 39.6% of the amount over $271,050
	Married individuals filing joint returns
$0 to $41,200	15 percent of taxable income
$41,201 to $99,600 ..	$6,180, plus 28% of the amount over $41,200
$99,601 to $151,750	$22,532, plus 31% of the amount over $99,600
$151,751 to $271,050	$38,698, plus 36% of the amount over $151,750
Over $271,050	$81,646, plus 39.6% of the amount over $271,050
	Married individuals filing separate returns
$0 to $20,600	15 percent of taxable income
$20,601 to $49,800 ..	$3,090, plus 28% of the amount over $20,600
$49,801 to $75,875 ..	$11,266, plus 31% of the amount over $49,800
$75,876 to $135,525	$19,349, plus 36% of the amount over $75,875
Over $135,525	$40,823 plus 39.6% of the amount over $135,525

House Bill

Designation of D.C. Enterprise Zone

Certain economically depressed census tracts within the District of Columbia are designated as the "D.C. Enterprise Zone," within which businesses and individual residents are eligible for special tax incentives. The census tracts that compose the D.C. Enterprise Zone are (1) all census tracts that presently are part of the D.C. enterprise community designated under section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District) and (2) all additional census tracts within the District of Columbia where the poverty rate is at least 35 percent. The D.C. Enterprise Zone designation generally will remain in effect for five years for the period from January 1, 1998, through December 31, 2002.[12]

The following tax incentives will take effect only if, prior to January 1, 1998, a Federal law is enacted creating a District of Co-

[12] The status of certain census tracts within the District as an enterprise community designated under section 1391 also terminates on December 31, 2002.

lumbia economic development corporation that is an instrumentality of the District of Columbia government.[13]

Business development incentives

Empowerment zone wage credit, expensing, and tax-exempt financing

The following tax incentives that are available under present law in empowerment zones would be available in the D.C. Enterprise Zone (modified as described below): (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. Enterprise Zone residents who work in the D.C. Enterprise Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.

In general, the wage credit for certain D.C. Enterprise Zone residents who work in the D.C. Enterprise Zone is the same as is available in empowerment zones under present law. However, the wage credit rate remains at 20 percent for the D.C. Enterprise Zone for the period 1998 through 2002 (and does not phase down to 15 percent in the year 2002 as under present-law section 1396). The wage credit is effective for wages paid (or incurred) to a qualified individual after December 31, 1997, and before January 1, 2003.

The increased expensing under Code section 179 is effective for property placed in service in taxable years beginning after December 31, 1997, and before January 1, 2003. Thus, qualified D.C. Zone property placed in service in taxable years beginning in 1998 is eligible for up to $38,500 of expensing.

A qualified D.C. Zone business (defined as under present law section 1394(b)(3)) is permitted to borrow proceeds from the issuance of qualified enterprise zone facility bonds. Such bonds can be issued only by a newly created economic development corporation and are subject to the requirements applicable under present law to enterprise zone facility bonds, except that the amount of outstanding bond proceeds that can be borrowed by any qualified District business cannot exceed $15 million (rather than $3 million). The special tax-exempt bond provisions apply to bonds issued after December 31, 1997, and prior to January 1, 2003.

Tax credits for equity investments in and loans to businesses located in the District of Columbia

A newly created economic development corporation is authorized to allocate $75 million in tax credits to taxpayers that make certain equity investments in, or loans to, businesses (either corporations or partnerships) engaged in an active trade or business in the District of Columbia. The business need not be located in the D.C. Enterprise Zone, although factors to be considered in the allocation of credits include whether the project would provide job opportunities for low and moderate income residents of the D.C. En-

[13] In addition, the House bill assumes the enactment of certain modifications to Federal law (other than Federal tax laws contained in the Internal Revenue Code) similar to those proposed by the Administration that would clarify and expand the District's authority to issue revenue bonds.

terprise Zone and whether the business is located in the D.C. Enterprise Zone. Eligible businesses are not be required to satisfy the criteria of a qualified D.C. Zone business, described above. Such credits are nonrefundable and can be used to offset a taxpayer's alternative minimum tax (AMT) liability.

Under the House bill, the amount of credit cannot exceed 25 percent of the amount invested (or loaned) by the taxpayer. Thus, the economic development corporation may allocate the full $75 million in tax credits to no less than $300 million in equity investments in, or loans, to eligible businesses.

Under the House bill, credits may be allocated to loans made to an eligible business only if the business uses the loan proceeds to purchase depreciable tangible property and any functionally related and subordinate land. Credits may be allocated to equity investments only if the equity interest was acquired for cash. Any credits allocated to a taxpayer making an equity investment are subject to recapture if the equity interest is disposed of by the taxpayer within five years. A taxpayer's basis in an equity investment is reduced by the amount of the credit.

The House bill applies to credit amounts allocated for taxable years beginning after December 31, 1997, and before January 1, 2003.[14]

Zero-percent capital gains rate

The House bill provides a zero-percent capital gains rate for capital gains from the sale of certain qualified "D.C. Zone assets" held for more than five years. In general, qualified "D.C. Zone assets" mean stock or partnership interests held in or tangible property held by a D.C. Zone business. For this purpose, a qualified D.C. Zone business is defined as an enterprise zone business under present-law section 1397B.

"D.C. Zone business stock" is stock in a domestic corporation originally issued after December 31, 1997, that, at the time of issuance[15] and during substantially all of the taxpayer's holding period, was a qualified D.C. Zone business, provided that such stock was acquired by the taxpayer on original issue from the corporation solely in exchange for cash before January 1, 2003.[16] A "D.C. Zone partnership interest" is a domestic partnership interest originally issued after December 31, 1997, that is acquired by the taxpayer from the partnership solely in exchange for cash before January 1, 2003, provided that, at the time such interest was acquired[17] and during substantially all of the taxpayer's holding period, the partnership was a qualified D.C. Zone business. Finally, "D.C. Zone business property" is tangible property acquired by the taxpayer by purchase (within the meaning of present law section 179(d)(2)) after December 31, 1997, and before January 1, 2003, provided that

[14] As a general business credit, the credit can be carried back three years (but not before January 1, 1998) and forward for 15 years.

[15] In the case of a new corporation, it is sufficient if the corporation is being organized for purposes of being a qualified D.C. Zone business.

[16] D.C. Zone business stock does not include any stock acquired from a corporation which made a substantial stock redemption or distribution (without a bona fide business purpose therefore) in an attempt to avoid the purposes of the provision. A similar rule applies with respect to D.C. Zone partnership interests.

[17] In the case of a new partnership, it is sufficient if the partnership is being formed for purposes of being a qualified D.C. Zone business.

the original use of such property in the D.C. Enterprise Zone commences with the taxpayer and substantially all of the use of such property during substantially all of the taxpayer's holding period was in a qualified D.C. Zone business of the taxpayer.

A special rule provides that, in the case of business property that is "substantially renovated," such property need not be acquired by the taxpayer after December 31, 1997, nor need the original use of such property in the D.C. Enterprise Zone commence with the taxpayer. For these purposes, property is treated as "substantially renovated" if, prior to January 1, 2003, additions to basis with respect to such property in the hands of the taxpayer during any 24-month period beginning after December 31, 1997, exceed the greater of (1) an amount equal to the adjusted basis at the beginning of such 24-month period in the hands of the taxpayer, or (2) $5,000. Thus, substantially renovated real estate located in the D.C. Enterprise Zone may constitute D.C. Zone business property. However, the House bill specifically excludes land that is not an integral part of a qualified D.C. Zone business from the definition of D.C. Zone business property.

In addition, qualified D.C. Zone assets include property that was a qualified D.C. Zone asset in the hands of a prior owner, provided that at the time of acquisition, and during substantially all of the subsequent purchaser's holding period, either (1) substantially all of the use of the property is in a qualified D.C. Zone business, or (2) the property is an ownership interest in a qualified D.C. Zone business.[18]

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. Zone asset that is (1) a capital asset or (2) property used in the trade or business as defined in section 1231(b). Gain attributable to periods before December 31, 1997, and after December 31, 2007, is not qualified capital gain. No gain attributable to real property, or an intangible asset, which is not an integral part of a qualified D.C. Zone business qualifies for the zero-percent rate.

The House bill provides that property that ceases to be a qualified D.C. Zone asset because the property is no longer used in (or no longer represents an ownership interest in) a qualified D.C. Zone business after the five-year period beginning on the date the taxpayer acquired such property would continue to be treated as a qualified D.C. Zone asset. Under this rule, the amount of gain eligible for the zero-percent capital gains rate cannot exceed the amount which would be qualified capital gain had the property been sold on the date of such cessation.

Special rules are provided for pass-through entities (i.e., partnerships, S corporations, regulated investment companies, and common trust funds). In the case of a sale or exchange of an interest in a pass-through entity that was not a qualified D.C. Zone business during substantially all of the period that the taxpayer held the interest, the zero-percent capital gains rate applies to the extent that the gain is attributable to amounts that would have been qualified capital gain had the assets been sold for their fair

[18] The termination of the D.C. Zone designation will not, by itself, result in property failing to be treated as a qualified D.C. Zone asset. However, capital gain eligible for the zero-percent capital gains rate does not include any gain attributable to periods after December 31, 2007.

market value on the date of the sale or exchange of the interest in the pass-through entity. This rule applies only if the interest in the pass-through entity were held by the taxpayer for more than five years. In addition, the rule applies only to qualified D.C. Zone assets that were held by the pass-through entity for more than five years, and throughout the period that the taxpayer held the interest in the pass-through entity.

The House bill also provides that in the case of a transfer of a qualified D.C. Zone asset by gift, at death, or from a partnership to a partner that held an interest in the partnership at the time that the qualified D.C. Zone asset was acquired, (1) the transferee is to be treated as having acquired the asset in the same manner as the transferor, and (2) the transferee's holding period includes that of the transferor. In addition, rules similar to those contained in section 1202(i)(2) regarding treatment of contributions to capital after the original issuance date and section 1202(j) regarding treatment of certain short positions apply.

Individual resident tax rate reduction

Individuals who have their principal place of abode in any census tract that is part of the D.C. Enterprise Zone are entitled to a 10-percent tax rate on all taxable income that currently is subject to a 15-percent Federal income tax rate. Thus, using the 1997 tax rate schedule, a single taxpayer who resides in the D.C. Enterprise Zone with $24,650 or more of taxable income will receive a Federal income tax reduction of $1,233 under the House bill. Married taxpayers who reside in the D.C. Enterprise Zone and file a joint return with taxable income of $41,200 or more of taxable income will receive a Federal income tax reduction of $2,060 under the House bill.

The special 10-percent rate provision is in effect for the period 1998–2007.

Effective date

The D.C. tax incentives generally are effective January 1, 1998, and remain in effect for five years until the termination of the D.C. Enterprise Zone designation on December 31, 2002. However, the zero-percent tax rate for capital gains and the special 10-percent rate bracket are effective for the period 1998–2007. All of the D.C. tax incentives are contingent upon the enactment of a Federal law, prior to January 1, 1998, creating a District of Columbia economic development corporation that is an instrumentality of the District of Columbia government.

Senate Amendment

First-time homebuyer credit

The Senate amendment provides first-time homebuyers of a principal residence in the District a tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit amount applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The Secretary of Treasury is directed to prescribe regulations allocating the credit among unmarried purchasers of a residence.[19]

To qualify as a "first-time homebuyer," neither the individual (nor the individual's spouse, if married) can have had a present ownership interest in a principal residence in the District for the one-year period prior to the date of acquisition of the principal residence.[20]

A taxpayer will be treated as a first-time homebuyer with respect to only one residence—i.e., the credit may be claimed one time only. The date of acquisition is the date on which a binding contract to purchase the principal residence is entered into or the date on which construction or reconstruction of such residence commences.

The credit applies to purchases after the date of enactment and before January 1, 2002. Any excess credit may be carried forward indefinitely to succeeding taxable years.

Tax credits for equity investments in and loans to businesses located in the District of Columbia

The Senate amendment is the same as the House bill, except that the economic development corporation is authorized to allocate $60 million (rather than $75 million) in credits.

Zero-percent capital gains rate

Like the House bill, the Senate amendment provides a zero-percent capital gains rate for capital gains from the sale of certain qualified D.C. assets held for more than five years. In general, qualified D.C. assets mean stock or partnership interests held in, or tangible property held by, a qualified D.C. business. However; the Senate amendment provides that capital gain from the sale of any D.C. asset acquired during calendar year 1998 shall be subject to tax at a 10 percent rate. A special rule provides that if the basis of any D.C. asset is determined in whole or part by reference to a D.C. asset acquired in 1998, all gain from the sale or exchange of such asset is taxed at the 10 percent rate.

Qualified D.C. business

A "qualified D.C. business" generally is required to satisfy the requirements of an "enterprise zone business" under present law, applied as if the District (in its entirety) were an empowerment zone. Thus, a corporation or partnership is a qualified D.C. business if: (1) its sole trade or business is the active conduct of a "qualified business" within the District; (2) at least 80 percent of the total gross income is derived from the active conduct of a "qualified business" within the District; (3) substantially all of the business's tangible property is used within the District; (4) substantially all of the business's intangible property is used in, and

[19] The provision of the Senate amendment that excludes sales of certain personal residences from the real estate transaction reporting requirement would not apply to sales of personal residences in the District of Columbia. In addition, the Senate amendment anticipates that the Secretary of Treasury will require such information as may be necessary to verify eligibility for the D.C. first-time homebuyer credit.

[20] Special rules apply to members of the Armed Forces and certain individuals with tax homes outside the United States with respect to whom the rollover period available under section 1034 (as in effect prior to the enactment of the bill) is suspended pursuant to section 1034 (h) or (k).

exclusively related to, the active conduct of such business; (5) substantially all of the services performed by employees are performed within the District; and (6) no more than 5 percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.[21] A "qualified business" means any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license.[22] In addition, the leasing of real property that is located within the District to others is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from qualified D.C. businesses. The rental of tangible personal property to others is not a qualified business unless substantially all of the rental of such property is by qualified D.C. businesses or by residents of the District.

Qualified D.C. assets

For purposes of the Senate amendment, qualified "D.C. assets" include (1) D.C. business stock, (2) D.C. partnership interests, and (3) D.C. business property.

"D.C. business stock" means stock in a domestic corporation originally issued after December 31, 1997, that, at the time of issuance[23] and during substantially all of the taxpayer's holding period, was a qualified D.C. business, provided that such stock was acquired by the taxpayer on original issue from the corporation solely in exchange for cash before January 1, 2003.[24] A "D.C. partnership interest" means a domestic partnership interest originally issued after December 31, 1997, that is acquired by the taxpayer from the partnership solely in exchange for cash before January 1, 2003, provided that, at the time such interest was acquired[25] and during substantially all of the taxpayer's holding period, the partnership was a qualified D.C. business. Finally, "D.C. business property" means tangible property acquired by the taxpayer by purchase (within the meaning of present law section 179(d)(2)) after December 31, 1997, and before January 1, 2003, provided that the original use of such property in the District commences with the taxpayer and substantially all of the use of such property during substantially all of the taxpayer's holding period was in a qualified D.C. business of the taxpayer.

A special rule provides that, in the case of business property that is "substantially renovated," such property need not be ac-

[21] The requirement under present-law section 1397B(b)(6) that at least 35 percent of the employees of the business be zone residents does not apply when determining whether an entity is a qualified D.C. business.

[22] Also, as under present law, a qualified business does not include certain facilities described in section 144(c)(6)(B) (e.g., massage parlor, hot tub facility, or liquor store) or certain large farms.

[23] In the case of a new corporation, it is sufficient if the corporation is being organized for purposes of being a qualified D.C. business.

[24] As under section 1202(c)(3), D.C. business stock does not include any stock acquired from a corporation which made a substantial stock redemption or distribution (without a bona fide business purpose therefore) in an attempt to avoid the purposes of the provision. A similar rule applies with respect to D.C. partnership interests.

[25] In the case of a new partnership, it is sufficient if the partnership is being formed for purposes of being a qualified D.C. business.

quired by the taxpayer after December 31, 1997, nor need the original use of such property in the District commence with the taxpayer. For these purposes, property is treated as "substantially renovated" if, prior to January 1, 2003, additions to basis with respect to such property in the hands of the taxpayer during any 24-month period beginning after December 31, 1997, exceed the greater of (1) an amount equal to the adjusted basis at the beginning of such 24-month period in the hands of the taxpayer, or (2) $5,000. Thus, substantially renovated real estate located in the District can constitute D.C. business property. However, the bill specifically excludes land that is not an integral part of a qualified D.C. business from the definition of D.C. business property.

In addition, qualified D.C. assets include property that was a qualified D.C. asset in the hands of a prior owner, provided that at the time of acquisition, and during substantially all of the subsequent purchaser's holding period, either (1) substantially all of the use of the property is in a qualified D.C. business, or (2) the property is an ownership interest in a qualified D.C. business.

In general, gain eligible for the zero-percent tax rate means gain from the sale or exchange of a qualified D.C. asset that is (1) a capital asset or (2) property used in the trade or business as defined in section 1231(b). Gain attributable to periods before December 31, 1997, is not qualified capital gain. No gain attributable to real property, or an intangible asset, which is not an integral part of a qualified D.C. business qualifies for the zero-percent rate.

The Senate amendment provides that property that ceases to be a qualified D.C. asset because the property is no longer used in (or no longer represents an ownership interest in) a qualified D.C. business after the five-year period beginning on the date the taxpayer acquired such property continues to be treated as a qualified D.C. asset. Under this rule, the amount of gain eligible for the zero-percent capital gains rate cannot exceed the amount which would be qualified capital gain had the property been sold on the date of such cessation.

Special rules are provided for pass-through entities (i.e., partnerships, S corporations, regulated investment companies, and common trust funds). In the case of a sale or exchange of an interest in a pass-through entity that was not a qualified D.C. business during substantially all of the period that the taxpayer held the interest, the zero-percent capital gains rate applies to the extent that the gain is attributable to amounts that would have been qualified capital gain had the underlying assets been sold for their fair market value on the date of the sale or exchange of the interest in the pass-through entity. This rule applies only if the interest in the pass-through entity were held by the taxpayer for more than five years. In addition, the rule applies only to qualified D.C. assets that were held by the pass-through entity for more than five years, and throughout the period that the taxpayer held the interest in the pass-through entity.

The Senate amendment also provides that, in the case of a transfer of a qualified D.C. asset by gift, at death, or from a partnership to a partner that held an interest in the partnership at the time that the qualified D.C. asset was acquired, (1) the transferee is to be treated as having acquired the asset in the same manner as the transferor, and (2) the transferee's holding period includes that of the transferor. In addition, rules similar to those contained in section 1202(i)(2) regarding treatment of contributions to capital after the original issuance date and section 1202(j) regarding treatment of certain short positions apply.

Trust fund for D.C. schools

The Senate amendment provides for a total of $50 million ($5 million for each year 1998 through 2007) to be transferred from Federal income taxes paid by District individual residents to a Trust Fund for D.C. schools. Amounts in the Trust Fund are to be used to pay debt service on qualified D.C. school bonds, which are taxable bonds issued after March 31, 1998, by the District to finance the rehabilitation and repair of District schools.

Effective dates

The D.C. first-time homebuyer credit is effective for purchases after the date of enactment and before January 1, 2002. The tax credit for equity investments and loans applies to credit amounts allocated for taxable years beginning after December 31, 1997, and before January 1, 2003. The zero-percent tax rate for capital gains is effective for qualified D.C. assets purchased (or substantially renovated) during the period January 1, 1998, through December 31, 2002, for any gain accruing with respect to such assets after the date or purchase (or substantial renovation). The Trust Fund for D.C. schools will be funded $5 million per year for 1998 through 2007.

Conference Agreement

The conference agreement follows the House bill in part and the Senate amendment in part.

Designation of D.C. Enterprise Zone

The conference agreement includes the House bill provision that designates certain economically depressed census tracts within the District of Columbia as the "D.C. Enterprise Zone," within which businesses and individual residents are eligible for special tax incentives. Under the conference agreement, however, the census tracts that compose the D.C. Enterprise Zone for purposes of the wage credit, expensing, and tax-exempt financing incentives are expanded to include census tracts within the District of Columbia where the poverty rate is not less than 20 percent. Thus, the D.C. Enterprise Zone consists of (1) all census tracts that presently are part of the D.C. enterprise community designated under Code section 1391 (i.e., portions of Anacostia, Mt. Pleasant, Chinatown, and the easternmost part of the District) and (2) all additional census tracts within the District of Columbia where the poverty rate is not less than 20 percent. As under the House bill, the D.C. Enterprise Zone designation generally will remain in effect for five years for the period from January 1, 1998, through December 31, 2002.

Empowerment zone wage credit, expensing, and tax-exempt financing

The conference agreement includes the House bill provision with respect to the tax incentives that are available in the D.C. Enterprise Zone, modified to provide that the wage credit is available with respect to all residents of the District and is not limited to residents of the D.C. Enterprise Zone and to eliminate the requirement that 35 percent of the employees of a qualified "D.C. Zone business" must be residents of the D.C. Enterprise Zone.[26] Thus, the following tax incentives that are available under present law in empowerment zones generally will be available in the D.C. Enterprise Zone: (1) a 20-percent wage credit for the first $15,000 of wages paid to D.C. residents who work in the D.C. Enterprise Zone; (2) an additional $20,000 of expensing under Code section 179 for qualified zone property; and (3) special tax-exempt financing for certain zone facilities.[27] The conference agreement does not include the provision limiting the special tax-exempt financing benefits to bonds issued by the Economic Development Corporation.

Zero-percent capital gains rate

The conference agreement includes the House bill provision that provides a zero-percent capital gains rate for capital gains from the sale of certain qualified D.C Zone assets held for more than five years. For purposes of the zero-percent capital gains rate, the D.C. Enterprise Zone is defined to include all census tracts within the District of Columbia where the poverty rate is not less than 10 percent.

For purposes of the zero-percent capital gains rate, the definition of qualified "D.C. Zone business" generally is the same as the definition applicable for purposes of the increased expensing described above. However, solely for purposes of the zero-percent capital gains rate, a qualified "D.C. Zone business" must derive at least 80 percent (as opposed to 50 percent) of its total gross income from the active conduct of a "qualified business" within the D.C. Enterprise Zone.

First-time homebuyer tax credit

The conference agreement includes the Senate amendment provision that allows first-time homebuyers of a principal residence in the District a tax credit of up to $5,000 of the amount of the purchase price, except that the credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). The conference agreement clari-

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[26] The provision of the conference agreement that authorizes the designation of additional empowerment zones also modifies the definition of an enterprise zone business to provide that, in addition to satisfying the other requirements of section 1397B, at least 50 percent (as opposed to 80 percent under present law) of the total gross income of a qualified enterprise zone business must be derived from the active conduct of a "qualified business" within a zone or community. The conference agreement makes certain other modifications to the definition of an enterprise zone business as well. This modified definition of enterprise zone business, determined without regard to the 35-percent zone resident employee requirement, generally applies for purposes of the increased expensing and tax-exempt financing available in the D.C. Enterprise Zone.

[27] The provision of the conference agreement that authorizes the designation of additional empowerment zones contains certain modifications to the rules applicable to present-law empowerment zone facility bonds. Such modifications (not including the exception to the volume cap) will apply in the D.C. Enterprise Zone as well.

fies that the credit is available with respect to purchases of existing property as well as new construction, and specifies that a taxpayer's basis in a property is reduced by the amount of any homebuyer tax credit claimed with respect to such property. In addition, the conference agreement sunsets the credit after December 31, 2000. Thus, the credit is available with respect to property purchased after the date of enactment and before January 1, 2001.

VIII. WELFARE-TO-WORK TAX CREDIT

(sec. 801 of the House bill)

Present Law

The work opportunity tax credit is available on an elective basis for employers hiring individuals from one or more of seven targeted groups. The credit generally is equal to 35 percent of qualified wages. Generally, qualified wages consist of wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual begins work for the employer.

For purposes of the work opportunity tax credit, the targeted groups for which the credit is available include: (1) families receiving Aid to Families with Dependent Children ("AFDC'); (2) qualified ex-felons; (3) high-risk youth; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; and (7) families receiving food stamps.

Generally, no more than $6,000 of wages during the first year of employment is permitted to be taken into account with respect to any individual. Thus, the maximum credit per individual is $2,100. With respect to qualified summer youth employees, the maximum credit is 35 percent of up to $3,000 of qualified first-year wages, for a maximum credit of $1,050.

The deduction for wages is reduced by the amount of the credit.

The work opportunity tax credit is effective for wages paid or incurred to a qualified individual who begins work for an employer after September 30, 1996, and before October 1, 1997.

House Bill

The House bill provides to employers a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assistance (AFDC or its successor program) recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within 2 years after the date that the 18-month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

Effective date.—The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after January 1, 1998 and before May 1, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

IX. MISCELLANEOUS PROVISIONS

A. Excise Tax Provisions

1. Repeal excise tax on diesel fuel used in recreational motorboats (sec. 901 of the House bill and sec. 701 of the Senate amendment)

Present Law

Before a temporary suspension through December 31, 1997 was enacted in 1996, diesel fuel used in recreational motorboats was subject to the 24.3-cents-per-gallon diesel fuel excise tax. Revenues from this tax were retained in the General Fund.

House Bill

The House bill repeals the application of the diesel fuel tax to fuel used in recreational motorboats.

Effective date.—The provision is effective for fuel sold after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Continued application of tax on imported recycled halon-1211 (sec. 902 of the House bill)

Present Law

An excise tax is imposed on the sale or use by the manufacturer or importer of certain ozone-depleting chemicals (Code sec. 4681). The amount of tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to each taxable chemical. The base tax amount is $6.25 per pound in 1997, and is scheduled to increase by 45 cents per pound per year thereafter. The ozone-depleting factors for taxable halons are 3 for halon-1211, 10 for halon-1301, and 6 for halon-2402.

Taxable chemicals that are recovered and recycled within the United States are exempt from tax. In addition, exemption is provided for imported recycled halon-1301 and halon-2402 if such chemicals are imported from countries that are signatories to the Montreal Protocol on Substances that Deplete the Ozone Layer. Present law further provides that exemption is to be provided for imported recycled halon-1211, for such chemicals imported from countries that are signatories to the Montreal Protocol on Substances that Deplete the Ozone Layer after December 31, 1997.

House Bill

The House bill repeals the present-law exemption for imported recycled halon-1211.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Transfer of General Fund highway fuels tax revenues to the Highway Trust Fund (sec. 704 of the Senate amendment)

Present Law

The Highway Trust Fund receives revenues from taxes on gasoline and special motor fuels (14 cents per gallon) and diesel fuel (20 cents per gallon) used in highway vehicles, through September 30, 1999. These fuels also are subject to an additional, permanent 4.3-cents-per-gallon rate. Revenues from the 4.3-cents-per-gallon rate are retained in the General Fund.

Excise taxes imposed on these three motor fuels (gasoline, diesel fuel, and special motor fuels) generally must be paid to the Treasury in semi-monthly deposits, which are credited to tax liability that is reported on quarterly returns. Subject to special rules for deposits attributable to taxes for the period September 16–26, deposits generally must be made 9 days after the end of each semimonthly period (14 days in the case of gasoline and diesel fuel taxes deposited electronically).

House Bill

No provision.

Senate Amendment

Transfer of revenues to Highway Trust Fund.—Revenues from the General Fund 4.3-cents-per-gallon tax (net of 0.5-cent-per-gallon transferred to a new Intercity Passenger Rail Fund under sec. 702 of the Senate amendment for the period, October 1, 1997–April 15, 2001) are transferred to the Highway Trust Fund. Of such amounts transferred to the Highway Trust Fund, 20 percent are to be credited to the Mass Transit Account and 80 percent to the Highway Account.

Conforming amendments ensure that no direct spending increases will occur as a result of the provision.

Deposit rules for highway motor fuels taxes.—No provision.

Effective date.—October 1, 1997.

Conference Agreement

Transfer of revenues to Highway Trust Fund.—The conference agreement follows the Senate amendment with a modification to reflect deletion from the agreement of the Senate amendment provision transferring 0.5 cents per gallon of these revenues to a new Intercity Passenger Rail Fund. As under the Senate amendment, revenues from the 4.3-cents-per-gallon tax will be divided between the Highway Trust Fund's Highway Account (3.45 cents per gallon) and Mass Transit Account (0.85 cents per gallon).

Deposit rules for highway motor fuels taxes.—The conference agreement provides that the excise taxes imposed on gasoline (sec. 4081), diesel fuel (sec. 4081), special motor fuels (sec. 4041), and kerosene (sec. 4081) that otherwise would be required to be deposited with the Treasury after July 31, 1998, and before September 30, 1998, are not required to be deposited until October 5, 1998.

4. Tax certain alternative fuels based on energy equivalency to gasoline (sec. 705 of the Senate amendment)

Present Law

Special motor fuels are subject to an 18.3-cents-per-gallon excise tax: 14 cents per gallon of the tax is dedicated to the Highway Trust Fund, and the remaining 4.3 cents per gallon is retained in the General Fund. Special motor fuels include propane, methanol derived from natural gas, liquefied natural gas, and compressed natural gas. Reduced tax rates apply to methanol from natural gas and compressed natural gas.

House Bill

No provision.

Senate Amendment

The Senate amendment adjusts the aggregate tax rates imposed on propane, liquefied natural gas, and methanol derived from natural gas to reflect the energy content of these fuels relative to gasoline. The revised tax rates per gallon (through September 30, 1999) are—

Propane	13.6 cents.
Methanol	9.15 cents.
Liquified natural gas	11.9 cents.

After September 30, 1999, these three fuels will be taxed based on Btu equivalency to gasoline's 4.3-cents-per-gallon rate. No change is made to the current reduced tax rate on compressed natural gas.

Effective date.—October 1, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Extend and modify tax benefits for ethanol (sec. 605 of the House bill and sec. 707 of the Senate amendment)

Present Law

Ethanol used as a fuel is eligible for a 54-cents-per-gallon tax benefit. The benefit may be claimed either as an income tax credit, through reduced excise tax on sales of gasoline that is blended with ethanol, or by expedited refunds of tax paid on such gasoline. This benefit is scheduled to expire after September 30, 1999. However, provisions relating to excise taxes dedicated to trust funds generally are assumed to be permanent for budget scorekeeping purposes.

House Bill

The House bill provides that preferential excise tax rates (and associated credits and refunds) that statutorily are scheduled to expire are not assumed to be permanent for budget scorekeeping purposes.

Senate Amendment

The Senate amendment extends the ethanol tax benefit through 2007, and modifies the benefit rate per gallon of alcohol, as follows: 2001 and 2002—53 cents; 2003 and 2004—52 cents; and 2005, 2006, and 2007—51 cents.

Effective date.—Date of enactment.

Conference Agreement

No provision (i.e., the conference agreement does not include either the House bill or the Senate amendment provision).

6. Treat certain gasoline "chain retailers" as wholesale distributors under the gasoline excise tax refund rules (sec. 904 of the House bill)

Present Law

Gasoline is taxed at 18.3 cents per gallon upon removal from a registered pipeline or barge terminal facility. The position holder in the terminal at the time of removal is liable for payment of the tax. Certain uses of gasoline, including use by States and local governments, are exempt from tax. In general, these exemptions are realized by refunds to the exempt users of tax paid by the party that removed the gasoline from a terminal facility. Present law includes an exception to the general rule that refunds are made to consumers in the case of gasoline sold to States and local governments and certain other exempt users. In those cases, wholesale distributors sell the gasoline net of tax previously paid and receive the refunds. The term wholesale distributor includes only persons that sell gasoline to producers, retailers, or to users in bulk quantities. Retailers that are not also wholesale distributors do not qualify, regardless of their size.

House Bill

The definition of wholesale distributor is expanded to include certain "chain retailers"—retailers who own and make retail sales from 10 or more retail gasoline outlets. This modification conforms the definition of wholesale distributor to that which existed before 1987 when the point of collection of the gasoline tax was moved from the wholesale distribution level to removal from a terminal facility.

Effective date.—The provision is effective after September 30, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

7. Exemption of electric and other clean-fuel motor vehicles from luxury automobile classification (sec. 905 of the House bill)

Present Law

Present law imposes an excise tax on the sale of automobiles whose price exceeds a designated threshold, currently $36,000. The excise tax is imposed at a rate of 8 percent for 1997 on the excess of the sales price above the designated threshold. The 8-percent rate declines by one percentage point per year until reaching 3 percent in 2002, and no tax thereafter. The $36,000 threshold is indexed for inflation. The present-law indexed threshold of $36,000 is the result of adjusting a $30,000 threshold specified in the Code for inflation occurring after 1990 (sec. 4001(e)).

The tax generally applies only to the first retail sale after manufacture, production, or importation of an automobile. It does not apply to subsequent sales of taxable automobiles. A 10-percent tax is imposed on the separate purchase of parts and accessories for a vehicle within six months of the first retail sale when the sum of the separate purchases of the vehicle, parts, and accessories exceeds the luxury tax threshold (sec. 4003).[28]

The tax under section 4001 applies to sales before January 1, 2003. The tax under section 4003 has no termination date.[29]

House Bill

The House bill modifies the threshold above which the luxury excise tax on automobiles will apply for each of two identified classes of automobiles both in the case of a purchase of a vehicle and in the case of the separate purchase of a vehicle and parts and accessories therefor. First, for an automobile that is not a clean-burn-

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[28] The rate of tax under section 4003 is not determined by reference to section 4001. However, a technical correction under the bill (Title XV) conforms the tax rate applicable under section 4003 to that applicable under section 4001.

[29] A technical correction under both the House bill (Title XV) and the Senate amendment (Title XIV) conforms the expiration date of the tax under section 4003 to the expiration date under section 4001.

ing fuel vehicle to which retrofit parts and components are installed to make the vehicle a clean-burning vehicle, the threshold would be $30,000, as adjusted for inflation under present law, plus an amount equal to the increment to the retail value of the automobile attributable to the retrofit parts and components installed.

In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the threshold applicable for any year is modified to equal 150 percent of $30,000, with the result increased for inflation occurring after 1990 and rounded to the next lowest multiple of $2,000.

Effective date.—The provision is effective for sales and installations occurring on or after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to the effective date that provides that the provision is effective for sales and installations occurring after the date of enactment.

8. Reduce rate of alcohol excise tax on certain hard ciders (sec. 703 of the Senate amendment)

Present Law

Distilled spirits are taxed at a rate of $13.50 per proof gallon; beer is taxed at a rate of $18 per barrel (approximately 58 cents per gallon); and still wines of 14 percent alcohol or less are taxed at a rate of $1.07 per wine gallon. Higher rates of tax are applied to wines with greater alcohol content and to sparkling wines (champagne).

Certain small wineries may claim a credit against the excise tax on wine of 90 cents per wine gallon on the first 100,000 gallons of wine produced annually (i.e., net tax rate of 17 cents per wine gallon). Certain small breweries pay a reduced tax of $7.00 per barrel (approximately 22.6 cents per gallon) on the first 60,000 barrels of beer produced annually.

Apple cider containing alcohol ("hard cider") is classified and taxed as wine.

House Bill

No provision.

Senate Amendment

The Senate amendment adjusts the tax rate on apple cider having an alcohol content of no more than 7 percent to 22.6 cents per gallon for those persons who produce more than 100,000 gallons of "hard cider" during a calendar year. The tax rate applicable to hard cider produced by persons who produce 100,000 gallons or less in a calendar year will remain as under present law and those persons may continue to claim the 90 cents per wine gallon credit permitted for small wineries. Hard cider production will continue to be counted in determining whether other production of a producer qualifies for the tax credit for small producers. The Senate amendment does not change the classification of qualifying hard cider as wine.

Effective date.—The provision is effective for hard cider removed after September 30, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

9. Study feasibility of moving collection point for distilled spirits excise tax (sec. 706 of the Senate amendment)

Present Law

Distilled spirits are subject to tax at $13.50 per proof gallon. (A proof gallon is a liquid gallon consisting of 50 percent alcohol.) In the case of domestically produced distilled spirits and distilled spirits imported into the United States in bulk containers for domestic bottling, the tax is imposed on removal of the beverage from the distillery (without regard to whether a sale occurs at that time). Bottled distilled spirits that are imported into the United States comprise approximately 15 percent of the current market for these beverages; tax is imposed on these imports when the distilled spirits are removed from the first customs bonded warehouse in which they are deposited upon entry into the United States.

In the case of certain distilled spirits products, a tax credit for alcohol derived from fruit is allowed. This credit reduces the effective tax paid on those beverages. The credit is determined when the tax is paid (i.e., at the distillery or on importation).

House Bill

No provision.

Senate Amendment

The Treasury Department is directed to study options for changing the point at which the distilled spirits excise tax is collected. One of the options evaluated should be collecting the tax at the point at which the distilled spirits are removed from registered wholesale warehouses. As part of this study, the Treasury is to focus on administrative issues associated with the identified options, including the effects on tax compliance. For example, the Treasury is to evaluate the actual compliance record of wholesale dealers that currently pay the excise tax on imported bottled distilled spirits, and the compliance effects of allowing additional wholesale dealers to be distilled spirts taxpayers. The study also is to address the number of taxpayers involved, the types of financial responsibility requirements that might be needed, and any special requirements regarding segregation of non-tax-paid distilled spirits from other products carried by the potential new taxpayers. The study further is to review the effects of the options on Treasury staffing and other budgetary resources as well as projections of the time between when tax currently is collected and the time when tax otherwise would be collected.

The study is required to be completed and transmitted to the Senate Committee on Finance and the House Committee on Ways and Means no later than January 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment with a modification delaying the due date of the study to March 31, 1998.

10. Codify Treasury Department regulations regulating wine labels (sec. 708 of the Senate amendment)

Present Law

The Code includes provisions regulating the labeling of wine when it is removed from a winery for marketing. In general, the regulations under these provisions allow the use of semi-generic names for wine that reflect geographic identifications understood in the industry, provided that the labels include clear indication of any deviation from that which is generally understood in the source of the grapes or the process by which the wine is produced.

House Bill

No provision.

Senate Amendment

The current Treasury Department regulations governing the use of semi-generic wine designations which reflect geographic origin are codified into the Code's wine labeling provisions.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with a modification deleting the Secretary of the Treasury's discretion to eliminate currently listed semi-generic names.

11. Uniform rate of excise tax on vaccines (sec. 903 of the House bill and sec. 844 of the Senate amendment)

Present Law

A manufacturer's excise tax is imposed on the following vaccines routinely recommended for administration to children: DPT (diphtheria, pertussis, tetanus,), $4.56 per dose; DT (diphtheria, tetanus), $0.06 per dose; MMR (measles, mumps, or rubella), $4.44 per dose; and polio, $0.29 per dose. In general, if any vaccine is administered by combining more than one of the listed taxable vaccines, the amount of tax imposed is the sum of the amounts of tax imposed for each taxable vaccine. However, in the case of MMR and its components, any component vaccine of MMR is taxed at the same rate as the MMR-combined vaccine.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines.

House Bill

The House bill replaces the present-law excise tax rates, that differ by vaccine, with a single rate tax of $0.84 per dose on any listed vaccine component. Thus, the House bill provides that the tax applied to any vaccine that is a combination of vaccine components is 84 cents times the number of components in the combined vaccine. For example, the MMR vaccine is to be taxed at a rate of $2.52 per dose and the DT vaccine is to be taxed at rate of $1.68 per dose.

In addition, the House bill adds three new taxable vaccines to the present-law taxable vaccines: (1) HIB (haemophilus influenza type B); (2) Hepatitis B; and (3) varicella (chickenpox). The three newly listed vaccines also are subject to the 84-cents per dose excise tax.

Effective date.—The provision is effective for vaccine purchases after September 30, 1997. No tax is to be collected or refunds permitted for amounts held for sale on October 1, 1997.

Senate Amendment

The Senate amendment is the same as the House bill regarding rates of tax and taxable vaccines. In addition, the committee report on the Senate amendment directs the Secretary of the Treasury to undertake a study of the efficacy of the new flat-rate vaccine tax system as a means to finance the Vaccine Injury Compensation Trust Fund. Results of the Treasury study are to be submitted to the Senate Committee on Finance and the House Committee on Ways and Means by September 30, 1999.

Effective date.—The provision is effective for vaccine purchases after September 30, 1997. No floor stocks tax is to be collected or refunds permitted for amounts held for sale on October 1, 1997. Returns to the manufacturer occurring on or after October 1, 1997, are assumed to be returns of vaccines to which the new rates of tax apply.

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment by imposing a uniform rate of tax, but at a rate of $0.75 per dose on any listed vaccine component. The conference agreement also adds the HIB (haemophilus influenza type B), Hepatitis B, and varicella (chickenpox) vaccines to the list of taxable vaccines.

The conference agreement does not require the Secretary to study the new vaccine tax structure.

Effective date.—The provision is effective for sales after the date of enactment. No floor stocks tax is to be collected, or floor stocks refunds permitted, for vaccines held on the effective date. For the purpose of determining the amount of refund of tax on a vaccine returned to the manufacturer or importer, for vaccines returned after the date of enactment and before January 1, 1999, the amount of tax assumed to have been paid on the initial purchase of the returned vaccine shall not exceed $0.75 per dose.

B. Disaster Relief Provisions

1. Authority to postpone certain tax-related deadlines by reason of presidentially declared disaster (sec. 921 of the House bill)

Present Law

In the case of a Presidentially declared disaster, the Secretary of the Treasury has the authority to postpone some (but not all) tax-related deadlines.

House Bill

The House bill provides that, in the case of a taxpayer determined to be affected by a Presidentially declared disaster, the Secretary may specify that, for a period of up to 90 days, certain taxpayer deadlines are postponed. The deadlines that may be postponed are the same as are postponed by reason of service in a combat zone. The provision does not apply for purposes of determining interest on any overpayment or underpayment.

Effective date.—The provision is effective for any period for performing an act that has not expired before the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that it is applicable to all deadlines (not just taxpayer deadlines).

2. Use of certain appraisals to establish amount of disaster loss (sec. 922 of the House bill)

Present Law

In order to claim a disaster loss, a taxpayer must establish the amount of the loss. This may, for example, be done through the use of an appraisal.

House Bill

The House bill provides that nothing in the Code should be construed to prohibit Treasury from issuing guidance providing that an appraisal for the purpose of obtaining a Federal loan or Federal loan guarantee as the result of a Presidentially declared disaster may be used to establish the amount of a disaster loss.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Treatment of livestock sold on account of weather-related conditions (sec. 923 of the House bill and sec. 721 of the Senate amendment)

Present Law

In general, cash-method taxpayers report income in the year it is actually or constructively received. However, present law contains two special rules applicable to livestock sold on account of drought conditions. Code section 451(e) provides that a cash-method taxpayer whose principal trade or business is farming who is forced to sell livestock due to drought conditions may elect to include income from the sale of the livestock in the taxable year following the taxable year of the sale. This elective deferral of income is available only if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for drought conditions that resulted in the area being designated as eligible for Federal assistance. This exception is generally intended to put taxpayers who receive an unusually high amount of income in one year in the position they would have been in absent the drought.

In addition, the sale of livestock (other than poultry) that is held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for drought conditions is treated as an involuntary conversion under section 1033(e). Consequently, gain from the sale of such livestock could be deferred by reinvesting the proceeds of the sale in similar property within a two-year period.

House Bill

The House bill amends Code section 451(e) to provide that a cash-method taxpayer whose principal trade or business is farming and who is forced to sell livestock due not only to drought (as under present law), but also to floods or other weather-related conditions, may elect to include income from the sale of the livestock in the taxable year following the taxable year of the sale. This elective deferral of income is available only if the taxpayer establishes that, under the taxpayer's usual business practices, the sale would not have occurred but for the drought, flood or other weather-related conditions that resulted in the area being designated as eligible for Federal assistance.

In addition, the bill amends Code section 1033(e) to provide that the sale of livestock (other than poultry) that are held for draft, breeding, or dairy purposes in excess of the number of livestock that would have been sold but for drought (as under present law), flood or other weather-related conditions is treated as an involuntary conversion.

Effective date.—The provision applies to sales and exchanges after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Mortgage bond financing for residences located in Presidentially declared disaster areas (sec. 924 of the House bill and sec. 723 of the Senate amendment)

Present Law

Qualified mortgage bonds are private activity tax-exempt bonds issued by States and local governments acting as conduits to provide mortgage loans to first-time home buyers who satisfy specified income limits and who purchase homes that cost less than statutory maximums.

Present law waives the three buyer targeting requirements for a portion of the loans made with proceeds of a qualified mortgage bond issue if the loans are made to finance homes in statutorily prescribed economically distressed areas.

House Bill

The House bill waives the first-time homebuyer requirement, the income limits, and the purchase price limits for loans to finance homes in certain Presidentially declared disaster areas. The waiver applies only during the one-year period following the date of the disaster declaration.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 2000.

Senate Amendment

The Senate amendment is the same as the House bill except for the effective date.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996, and before January 1, 1999.

Conference Agreement

The conference agreement allows the waivers of the first-time homebuyer requirement, the income limits, and the purchase price limits for loans to finance homes in certain Presidentially declared disaster areas. The waiver applies only during the two-year period following the date of disaster declaration.

Effective date.—The provision applies to loans financed with bonds issued after December 31, 1996 and before January 1, 1999 (i.e., is the same as the Senate amendment).

5. Rules relating to denial of earned income credit on basis of disqualified income (sec. 722 of the Senate amendment)

Present Law

For taxable years beginning after December 31, 1995, an individual is not eligible for the earned income credit if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds $2,200. This threshold is indexed for inflation. Disqualified income is the sum of:

(1) interest (taxable and tax-exempt);
(2) dividends;
(3) net rent and royalty income (if greater than zero);
(4) capital gain net income and;
(5) net passive income (if greater than zero) that is not self-employment income.

House Bill

No provision.

Senate Amendment

The Senate amendment clarifies that gain or loss from the sale of livestock (as defined under sec.1231(b)(3) of the Code) is disregarded for purposes of the calculation of capital gain net income under the disqualified income test of the earned income credit.

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

Conference Agreement

The conference agreement does not include the Senate amendment.

6. Penalty-free withdrawals from IRAs for disaster-related expenses (sec. 724 of the Senate amendment)

Present Law

Under present law, amounts held in an individual retirement arrangement ("IRA") are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Amounts withdrawn prior to attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, or is used to purchase health insurance of an unemployed individual.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the 10-percent early withdrawal tax does not apply to distributions from IRAs made to a taxpayer for qualified disaster-related expenses.

The penalty-free withdrawal is available for "qualified disaster-related distributions" meaning distributions made to pay for the repair or replacement of tangible property which was located in a disaster area and was destroyed or substantially damaged as a result of the disaster. The term "disaster area" means an area determined by the President of the United States during 1997 to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

The penalty-free withdrawal rule only applies to qualified disaster distributions that (1) are made within the 2-year period beginning on the date the determination is made that the area is a disaster area, (2) are used by the taxpayer within 60 days of the payment or distribution to pay for the disaster-related expenses, and (3) do not exceed $10,000 during the 2-year period.

Effective date.—The provision is effective for distributions after December 31, 1996, with respect to disasters occurring after such date.

Conference Agreement

The conference agreement does not include the Senate amendment.

7. Elimination of 10-percent floor for casualty losses resulting from Presidentially declared disaster (sec. 725 of the Senate amendment)

Present Law

Non-business casualty and theft losses are deductible as an itemized deduction only to the extent each loss is more than $100 and the total of all losses during the year is more than 10 percent of adjusted gross income ("AGI").

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the 10 percent of AGI floor for casualty losses resulting from a Presidentially declared disaster that occurs in 1997.

Effective date.—Disasters occurring in 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

8. Requirement to abate interest by reason of Presidentially declared disaster (sec. 726 of the Senate amendment)

Present Law

In the case of a Presidentially declared disaster, the Secretary of the Treasury has the authority to postpone some tax-related deadlines, but there is no authority to abate interest.

House Bill

No provision.

Senate Amendment

The Senate amendment requires the IRS to abate interest for the same period of time for which the IRS has provided an extension of time to file tax returns and pay taxes for individuals located in Presidentially declared disaster areas during 1997.

Effective date.—Disasters occurring in 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

C. Provisions Relating to Employment Taxes

1. Employment tax status of distributors of bakery products (sec. 931 of the House bill)

Present Law

Under a special statutory rule, bakery distributors are treated as employees for Social Security payroll tax purposes (even if they are independent contractors for income tax purposes) if: (1) their services are part of a continuing relationship with the person for whom they are performed; (2) the distributor's service contract contemplates that he or she will perform substantially all of the services personally; and (3) the distributor does not have a substantial investment in facilities used in the performance of services, excluding facilities used for transportation. Bakery drivers generally take the position that they are not employees under the statutory rule.

House Bill

The House bill deletes distributors of bakery products from the list of product and service distributors treated as statutory employees for Social Security payroll tax purposes. Thus, the status of such workers is determined under the generally applicable rules.

Effective date.—The provision is effective for services performed after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

2. Clarification of standard to be used in determining tax status of retail securities brokers (sec. 932 of the House bill and sec. 779 of the Senate amendment)

Present Law

Under present law, whether a worker is an employee or independent contractor generally is determined under a common-law facts and circumstances test. An employer-employee relationship is generally found to exist if the service recipient has not only the right to control the result to be accomplished by the work, but also the means by which the result is to be accomplished. Whether such control exists is determined based on the relevant facts and circumstances. The IRS training manual provides that if a business requires its workers to comply with rules established by a third party (e.g., municipal building codes related to construction), the fact that such rules are imposed should be given little weight in determining the worker's status.

House Bill

Under the House bill, in determining the status of a registered representative of a broker-dealer for Federal tax purposes, no weight is to be given to instructions from the service recipient which are imposed only in compliance with governmental investor protection standards or investor protection standards imposed by a governing body pursuant to a delegation by a Federal or State agency.

Effective date.—Services performed after December 31, 1997. No inference is intended that the provision is not present law.

Senate Amendment

Same as the House bill, except that the provision applies only for Federal income tax purposes.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the House bill.

3. Clarification of exemption from self-employment tax for certain termination payments received by former insurance salesmen (sec. 933 of the House bill)

Present Law

Under the self-employment contributions act ("SECA"), taxes are imposed on an individual's net earnings from self employment. In general, net earnings from self employment means the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed which are attributable to such trade or business. The SECA tax rate is the same as the combined employer and employee FICA rates (i.e., 12.4 percent for old age, survivors, and disability income (OASDI) and 2.9 percent for Medicare Hospital Insurance taxes) and the maximum amount of earnings subject to the OASDI portion of SECA taxes is coordinated with and is set at the same level as the maximum level of wages and salaries subject to the OASDI portion of FICA taxes ($65,400 for 1997). There is no limit on the amount of self-employment income subject to the HI portion of the tax.

Certain insurance salesmen are independent contractors and therefore subject to tax under SECA. Under case law, certain payments received by a former insurance salesmen who had sold insurance as an independent contractor are not net earnings from self employment and therefore are not subject to SECA. See, e.g., *Jackson* v. *Comm'r*, 108 TC No. 10 (1997); *Gump* v. *U.S.,* 86 F. 3d 1126 (CA FC 1996); *Milligan* v. *Comm'r,* 38 F. 3d 1094 (9th Cir. 1994).

House Bill

The House bill codifies case law by providing that net earnings from self employment do not include any amount received during the taxable year from an insurance company on account of services performed by such individual as an insurance salesman for such company if (1) such amount is received after termination of the individual's agreement to perform services for the company, (2) the individual performs no services for the company after such termination and before the close of the taxable year, (3) the amount of the payment depends solely on policies sold by the individual during the last year of the agreement and the extent to which such policies remain in force for some period after such termination, and does not depend on the length of service or overall earnings from services performed for the company, and (4) the payments are conditioned upon the salesman agreeing not to compete with the company for at least one year following such termination.

The House bill also amends the Social Security Act to provide that such termination payments are not treated as earnings for purposes of determining social security benefits.

No inference is intended with respect to the SECA tax treatment of payments that are not described in the proposal.

Effective date.—The provision is effective with respect to payments after December 31, 1997. No inference is intended that the proposal is not present law.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with clarifications with respect to the requirement as to the amount of the payments. The conference agreement clarifies that the provision applies if the amount of the payment depends primarily on policies sold by or credited to the account of the individual during the last year of the service agreement and/or the extent to which such policies remain in force for some period after such termination and does not depend on length of service or overall earnings. The conference agreement clarifies that the eligibility for the payment can be based on length of service or overall earnings.

4. Safe harbor for independent contractors (sec. 934 of the House bill)

Present Law

Under present law, whether a worker is an employee or independent contractor is generally determined under a common-law facts and circumstances test. An employer-employee relationship is generally found to exist if the service recipient has not only the right to control the result to be accomplished by the work, but also the means by which the result is to be accomplished. The Internal Revenue Service ("IRS") has developed a set of 20 factors for use in applying the common-law test.

Under a special safe harbor rule (section 530 of the Revenue Act of 1978), a service recipient may treat a worker as an independent contractor for employment tax purposes even though the worker is in fact an employee if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met. Section 530 does not apply to the worker and does not apply for income tax purposes. Section 530 does not apply to technical services personnel.

House Bill

In general

The House bill provides a statutory safe harbor for determining worker classification for Federal tax purposes. If the standards set forth in the bill are met, the worker is not treated as an employee and the service recipient (or payor) is not treated as an employer. If the safe harbor is not satisfied, the determination of the worker's status is made under the present-law rules.

Standards for determining whether individuals are not employees

Under the House bill, the following three sets of requirements have to be satisfied in order for a worker not to be treated as an employee: (1) worker requirements regarding the service recipient; (2) worker requirements regarding others; and (3) documentation requirements. The requirements regarding the worker are satisfied if, in connection with performing the services, the worker: (1) has a significant investment in assets and/or training; (2) incurs significant unreimbursed expenses; (3) agrees to perform the services for a particular amount of time or to complete a specific result and is liable for damages for early termination without cause; (4) is paid primarily on a commissioned basis; or (5) purchases products for resale.

The requirements regarding others are satisfied if one of the following two requirements is met: (1) a place of business requirement; or (2) a services available to the public requirement. The place of business requirement is satisfied if the worker: (1) has a principal place of business; (2) does not primarily perform services in the service recipient's place of business; or (3) pays a fair market rent for use of the service recipient's place of business. The services available to the public requirement is satisfied if the worker is not required to perform services exclusively for the service recipient, and during the year (or the preceding or subsequent year) the worker: (1) has performed a significant amount of services for other persons; (2) has offered to perform services for other persons through advertising, individual written or oral solicitations, listings with agencies, brokers, or other organizations that provide referrals, or other similar activities; or (3) provides service under a business name that is registered with (or licensed by) a State or a political subdivision (or an agency or instrumentality of a State or political subdivision).

The documentation requirement is satisfied if the services performed by the worker are performed pursuant to a written contract between the worker and the service recipient (or payor) and the contract provides that the worker will not be treated as an employee.

If the service recipient (or payor) fails to file the appropriate Federal tax returns (including information returns) with respect to a worker for a taxable year, the safe harbor is not available for such year.

Effective date

The provision is effective with respect to services performed after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

5. Combined employment tax reporting demonstration project (sec. 769 of the Senate amendment)

Present Law

Traditionally, Federal tax forms are filed with the Federal Government and State tax forms are filed with individual states. This necessitates duplication of items common to both returns. Some States have recently been working with the IRS to implement combined State and Federal reporting of certain types of items on one form as a way of reducing the burdens on taxpayers. The State of Montana and the IRS have cooperatively developed a system to combine State and Federal employment tax reporting on one form. The one form would contain exclusively Federal data, exclusively State data, and information common to both: the taxpayer's name, address, TIN, and signature.

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Implementation of the combined Montana-Federal employment tax reporting project has been hindered because the IRS interprets section 6103 to apply that provision's restrictions on disclosure to information common to both the State and Federal portions of the combined form, although these restrictions would not apply to the State with respect to the State's use of State-requested information if that information were supplied separately to both the State and the IRS.

House Bill

No provision.

Senate Amendment

The Senate amendment permits implementation of a demonstration project to assess the feasibility and desirability of expanding combined reporting in the future. There are several limitations on the demonstration project. First, it is limited to the State of Montana and the IRS. Second, it is limited to employment tax reporting. Third, it is limited to disclosure of the name, address, TIN, and signature of the taxpayer, which is information common to both the Montana and Federal portions of the combined form. Fourth, it is limited to a period of five years.

Effective date.—The provision is effective on the date of enactment, and will expire on the date five years after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with a technical modification providing a cross-reference to the provision in section 6103 of the Code.

D. Provisions Relating to Small Business

1. Delay imposition of penalties for failure to make payments electronically through EFTPS (sec. 941 of the House bill and sec. 731 of the Senate amendment)

Present Law

Employers are required to withhold income taxes and FICA taxes from wages paid to their employees. Employers also are liable for their portion of FICA taxes, excise taxes, and estimated payments of their corporate income tax liability.

The Code requires the development and implementation of an electronic fund transfer system to remit these taxes and convey deposit information directly to the Treasury (Code sec. 6302(h)[30]).

[30] This requirement was enacted in 1993 (sec. 523 of P.L. 103–182).

The Electronic Federal Tax Payment System ("EFTPS") was developed by Treasury in response to this requirement.[31] Employers must enroll with one of two private contractors hired by the Treasury. After enrollment, employers generally initiate deposits either by telephone or by computer.

The new system is phased in over a period of years by increasing each year the percentage of total taxes subject to the new EFTPS system. For fiscal year 1994, 3 percent of the total taxes are required to be made by electronic fund transfer. These percentages increased gradually for fiscal years 1995 and 1996. For fiscal year 1996, the percentage was 20.1 percent (30 percent for excise taxes and corporate estimated tax payments). For fiscal year 1997, these percentages increased significantly, to 58.3 percent (60 percent for excise taxes and corporate estimated tax payments). The specific implementation method required to achieve the target percentages is set forth in Treasury regulations. Implementation began with the largest depositors.

Treasury had originally implemented the 1997 percentages by requiring that all employers who deposit more than $50,000 in 1995 must begin using EFTPS by January 1, 1997. The Small Business Job Protection Act of 1996 provided that the increase in the required percentages for fiscal year 1997 (which, pursuant to Treasury regulations, was to take effect on January 1, 1997) will not take effect until July 1, 1997.[32] This was done to provide additional time prior to implementation of the 1997 requirements so that employers could be better informed about their responsibilities.

On June 2, 1997, the IRS announced[33] that it will not impose penalties through December 31, 1997, on businesses that make timely deposits using paper Federal tax deposit coupons while converting to the EFTPS system.

House Bill

The House bill provides that no penalty shall be imposed solely by reason of a failure to use EFTPS prior to January 1, 1999, if the taxpayer was first required to use the EFTPS system on or after July 1, 1997.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except it applies to penalties for failures to use EFTPS prior to July 1, 1998.

Conference Agreement

The conference agreement follows the Senate amendment.

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[31] Treasury had earlier developed TAXLINK as the prototype for EFTPS. TAXLINK has been operational for several years; EFTPS is currently operational. Employers currently using TAXLINK will ultimately be required to participate in EFTPS.

[32] Sec. 1809 of P.L. 104–188.

[33] IR–97–32.

2. Home office deduction: clarification of definition of principal place of business (sec. 942 of the House bill)

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)).[34] 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 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.[35] Because the taxpayer did not meet with patients at his home office and the room was not a separate structure, a deduction was not

[34] 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.

[35] 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.

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 or product samples 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)).

House Bill

Section 280A is amended 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 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 House bill, a home office deduction is 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 bill. Moreover, if a taxpayer conducts some administrative or management activities at a fixed location of the business outside the home, the taxpayer still is 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 bill 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 part of the test will be 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 chose 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. 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.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the provision is effective for taxable years beginning after December 31, 1998.

3. Increase deduction for health insurance costs of self-employed individuals (sec. 733 of the Senate amendment)

Present Law

Under present law, self-employed individuals are entitled to deduct the amount paid for health insurance for the self-employed individual and the individual's spouse and dependents as follows: the deduction is 40 percent in 1997; 45 percent in 1998 through 2002; 50 percent in 2003; 60 percent in 2004; 70 percent in 2005; and 80 percent in 2006 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse.

Under present law employees can exclude from income 100 percent of employee-provided health insurance.

House Bill

No provision.

Senate Amendment

The Senate amendment permits self-employed individuals to deduct a higher percentage of the amount paid for health insurance as follows: the deduction is 50 percent in 1997 and 1998; 60 percent in 1999 through 2002; 70 percent in 2003; 80 percent in 2004; 85 percent in 2005; 90 percent in 2006; and 100 percent in 2007 and all years thereafter.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the self-employed health deduction is phased up as follows: the deduction is 40 percent in 1997, 45 percent in 1998 and 1999, 50 percent in 2000 and 2001, 60 percent in 2002, 80 percent in 2003 through 2005, 90 percent in 2006, and 100 percent in 2007 and thereafter.

E. Other Provisions

1. Shrinkage estimates for inventory accounting (sec. 951 of the House bill and sec. 1013 of the Senate amendment)

Present Law

Section 471(a) provides that "(w)henever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income." Where a taxpayer maintains book inventories in accordance with a sound accounting system, the net value of the inventory will be deemed to be the cost basis of the inventory, provided that such book inventories are verified by physical inventories at reasonable intervals and adjusted to conform therewith.[36] The physical count is used to determine and adjust for certain items; such as undetected theft, breakage, and bookkeeping errors; collectively referred to as "shrinkage".

Some taxpayers verify and adjust their book inventories by a physical count taken on the last day of the taxable year. Other taxpayers may verify and adjust their inventories by physical counts taken at other times during the year. Still other taxpayers take physical counts at different locations at different times during the taxable year (cycle counting).

If a physical inventory is taken at year-end, the amount of shrinkage for the year is known. If a physical inventory is not taken at year-end, shrinkage through year-end will have to be based on an estimate, or not taken into account until the following year. In the first decision in *Dayton Hudson* v. *Commissioner*,[37] the U.S. Tax Court held that a taxpayer's method of accounting may include the use of an estimate of shrinkage occurring through year-end, provided the method is sound and clearly reflects income. In the second decision in *Dayton Hudson* v. *Commissioner*,[38] the U.S. Tax Court adhered to this holding. However, the U.S. Tax Court in the second decision determined that this taxpayer had not established that its method of accounting clearly reflected income. Other cases decided by the U.S. Tax Court[39] have held that taxpayers'

[36] Treas. reg. sec. 1.471–2(d).
[37] 101 T.C. 462 (1993).
[38] T.C. Memo 1997–260.
[39] *Wal-Mart* v. *Commissioner,* T.C. Memo 1997–1 and *Kroger* v. *Commissioner,* T.C. Memo 1997–2.

methods of accounting that included shrinkage estimates do clearly reflect income.

The U.S. Tax Court in the second *Dayton Hudson* opinion noted that "(I)n most cases, generally accepted accounting principles (GAAP), consistently applied, will pass muster for tax purposes. The Supreme Court has made clear, however, that GAAP does not enjoy a presumption of accuracy that must be rebutted by the Commissioner."

House Bill

The House bill provides that a method of keeping inventories will not be considered unsound, or to fail to clearly reflect income, solely because it includes an adjustment for the shrinkage estimated to occur through year-end, based on inventories taken other than at year-end. Such an estimate must be based on actual physical counts. Where such an estimate is used in determining ending inventory balances, the taxpayer is required to take a physical count of inventories at each location on a regular and consistent basis. A taxpayer is required to adjust its ending inventory to take into account all physical counts performed through the end of its taxable year.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

A taxpayer is permitted to change its method of accounting by this section if the taxpayer is currently using a method that does not utilize estimates of inventory shrinkage and wishes to change to a method for inventories that includes shrinkage estimates based on physical inventories taken other than at year-end. Such a change is treated as a voluntary change in method of accounting, initiated by the taxpayer with the consent of the Secretary of the Treasury, provided the taxpayer changes to a permissible method of accounting. The period for taking into account any adjustment required under section 481 as a result of such a change in method is 4 years.

No inference is intended by the adoption of this provision with regard to whether any particular method of accounting for inventories is permissible under present law.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with the following clarifications regarding safe harbor methods for the estimation of inventory shrinkage.

In general.—The conferees expect that the Secretary of the Treasury will issue guidance establishing one or more safe harbor methods for the estimation of inventory shrinkage that will be deemed to result in a clear reflection of income, provided such safe harbor method is consistently applied and the taxpayer's inventory methods otherwise satisfy the clear reflection of income standard.

Safe harbors applicable to retail trade.—In the case of taxpayers primarily engaged in retail trade (the resale of personal property to the general public), where physical inventories are normally taken at each location at least annually, the conferees anticipate that a safe harbor method will be established that will use a historical ratio of shrinkage to sales, multiplied by total sales between the date of the last physical inventory and year-end. This historical ratio is based on the actual shrinkage established by all physical inventories taken during the most recent three taxable years and the sales for related periods. The historical ratio should be separately determined for each store or department in a store of the taxpayer. The historical ratio, or estimated shrinkage determined using the historical ratio, cannot be adjusted by judgmental or other factors (e.g., floors or caps). The conferees expect that estimated shrinkage determined in accordance with the consistent application of the safe harbor method will not be required to be recalculated, through a lookback adjustment or otherwise, to reflect the results of physical inventories taken after year-end.

In the case of a new store or department in a store that has not verified shrinkage by a physical inventory in each of the most recent three taxable years, the historical ratio is the average of the historical ratios of the retailer's other stores or departments. Retailers using last in, first out (LIFO) methods of inventory are expected to be required to allocate shrinkage among their various inventory pools in a reasonable and consistent manner.

The conferees expect that procedures will be provided allowing an automatic election of such method of accounting for a taxpayer's first taxable year ending after the date of enactment. Any adjustment required by section 481 as a result of the change in method of accounting generally will be taken into account over a period of four years.

2. Treatment of workmen's compensation liability under rules for certain personal injury liability assignments (sec. 952 of the House bill)

Present Law

Under present law, an exclusion from gross income is provided for amounts received for agreeing to a qualified assignment to the extent that the amount received does not exceed the aggregate cost of any qualified funding asset (sec. 130). A qualified assignment means any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of a personal injury or sickness (in a case involving physical injury or physical sickness), provided the liability is assumed from a person who is a party to the suit or agreement, and the terms of the assignment satisfy certain requirements. Generally, these requirements are that: (1) the periodic payments are fixed as to amount and time; (2) the payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee's obligation is no greater than that of the assignor; and (4) the payments are excludable by the recipient under section 104(a)(2) as damages on account of personal injuries or sickness. Present law provides a separate exclusion under section 104(a)(1) for the recipient of amounts received under workmen's compensation acts as compensation for personal injuries or sickness, but a qualified assignment under section 130 does not include the assignment of a liability to make such payments.

House Bill

The House bill extends the exclusion for qualified assignments under Code section 130 to amounts assigned for assuming a liability to pay compensation under any workmen's compensation act. The provision requires that the assignee assume the liability from a person who is a party to the workmen's compensation claim, and requires that the periodic payment be excludable from the recipient's gross income under section 104(a)(1), in addition to the requirements of present law.

Effective date.—Effective for workmen's compensation claims filed after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Tax-exempt status for certain State workmen's compensation act companies (sec. 953 of the House bill and sec. 761 of the Senate amendment)

Present Law

In general, the Internal Revenue Service ("IRS") takes the position that organizations that provide insurance for their members or other individuals are not considered to be engaged in a tax-exempt activity. The IRS maintains that such insurance activity is either (1) a regular business of a kind ordinarily carried on for profit, or (2) an economy or convenience in the conduct of members' businesses because it relieves the members from obtaining insurance on an individual basis.

Certain insurance risk pools have qualified for tax exemption under Code section 501(c)(6). In general, these organizations (1) assign any insurance policies and administrative functions to their member organizations (although they may reimburse their members for amounts paid and expenses), (2) serve an important common business interest of their members, and (3) must be membership organizations financed, at least in part, by membership dues.

State insurance risk pools may also qualify for tax exempt status under section 501(c)(4) as a social welfare organizations or under section 115 as serving an essential governmental function of a State. In seeking qualification under section 501(c)(4), insurance organizations generally are constrained by the restrictions on the provision of "commercial-type insurance" contained in section 501(m). Section 115 generally provides that gross income does not include income derived from the exercise of any essential governmental function and accruing to a State or any political subdivision thereof.

House Bill

The House bill clarifies the tax-exempt status of any organization that is created by State law, and organized and operated exclusively to provide workmen's compensation insurance and related coverage that is incidental to workmen's compensation insurance,[40] and that meets certain additional requirements. The workmen's compensation insurance must be required by State law, or be insurance with respect to which State law provides significant disincentives if it is not purchased by an employer (such as loss of exclusive remedy or forfeiture of affirmative defenses such as contributory negligence). The organization must provide workmen's compensation to any employer in the State (for employees in the State or temporarily assigned out-of-State) seeking such insurance and meeting other reasonable requirements. The State must either extend its full faith and credit to debt of the organization or provide the initial operating capital of such organization. For this purpose, the initial operating capital can be provided by providing the proceeds of bonds issued by a State authority; the bonds may be repaid through exercise of the State's taxing authority, for example. For periods after the date of enactment, the assets of the organization must revert to the State upon dissolution. Finally, the majority of the board of directors (or comparable oversight body) of the organization must be appointed by an official of the executive branch of the State or by the State legislature, or by both.

Effective date.—Taxable years beginning after December 31, 1997. No inference is intended as to the status of such organizations under present law.

Senate Amendment

The Senate amendment is the same as the House bill. The Senate Finance committee report clarifies that related coverage that is incidental to workmen's compensation insurance includes liability under Federal workmen's compensation laws, the Jones Act, and the Longshore and Harbor Workers Compensation Act, for example. The Senate Finance committee report also clarifies that many organizations described in the provision have been operating as tax-exempt organizations. No inference is intended that organizations described in the provision are not tax-exempt under present law.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with modifications.

The conference agreement modifies the full-faith-and-credit portion of the requirement that the State must extend its full faith and credit to debt of the organization (or provide the initial operating capital of such organization). Under the conference agreement, the State must extend its full faith and credit to the initial debt of the organization.

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[40] Related coverage that is incidental to workmen's compensation insurance includes liability under Federal workmen's compensation laws, for example.

The conference agreement also modifies the requirement relating to reversion of assets to the State upon dissolution. The conference agreement requires that, in the case of periods after the date of enactment, either the assets of the organization must revert to the State upon dissolution, or State law must not permit the dissolution of the organization, absent an act of the State legislature. Should dissolution of the organization become permissible under applicable State law, then the requirement that the assets of the organization revert to the State upon dissolution applies.

Many organizations described in the provision have been operating as organizations that are exempt from tax (e.g., as an organization that is exempt from tax because it is serving an essential governmental function of a State). No inference is intended that organizations described in the provision are not exempt from tax under present law. In addition, no inference is intended that the benefit plans of such organizations are not properly maintained by the organization. It is anticipated that Federal regulatory agencies will take appropriate action to address transition issues faced by organizations to conform to their benefit plans under the provision. For example, it is intended that an organization that has been maintaining a section 457 plan as an agency or instrumentality of a State could (without creating any inference with respect to present-law treatment) freeze future contributions to the section 457 plan and establish a retirement arrangement (e.g., a section 401(k) plan) that is consistent with the treatment of the organization as a tax-exempt employer under the provision.

4. Election for 1987 partnerships to continue exception from treatment of publicly traded partnerships as corporations (sec. 954 of the House bill and sec. 762 of the Senate amendment)

Present Law

A publicly traded partnership generally is treated as a corporation for Federal tax purposes (sec. 7704). An exception to the rule treating the partnership as a corporation applies if 90 percent of the partnership's gross income consists of "passive-type income," which includes (1) interest (other than interest derived in a financial or insurance business, or certain amounts determined on the basis of income or profits), (2) dividends, (3) real property rents (as defined for purposes of the provision), (4) gain from the sale or other disposition of real property, (5) income and gains relating to minerals and natural resources (as defined for purposes of the provision), and (6) gain from the sale or disposition of a capital asset (or certain trade or business property) held for the production of income of the foregoing types (subject to an exception for certain commodities income).

The exception for publicly traded partnerships with "passive-type income" does not apply to any partnership that would be described in section 851(a) of the Code (relating to regulated investment companies, or "RICs"), if that partnership were a domestic corporation. Thus, a publicly traded partnership that is registered under the Investment Company Act of 1940 generally is treated as a corporation under the provision. Nevertheless, if a principal activity of the partnership consists of buying and selling of commodities (other than inventory or property held primarily for sale to customers) or futures, forwards and options with respect to commodities, and 90 percent of the partnership's income is such income, then the partnership is not treated as a corporation.

A publicly traded partnership is a partnership whose interests are (1) traded on an established securities market, or (2) readily tradable on a secondary market (or the substantial equivalent thereof).

Treasury regulations provide detailed guidance as to when an interest is treated as readily tradable on a secondary market or the substantial equivalent. Generally, an interest is so treated "if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable, economically, to trading on an established securities market" (Treas. Reg. sec. 1.7704–1(c)(1)).

When the publicly traded partnership rules were enacted in 1987, a 10-year grandfather rule provided that the provisions apply to certain existing publicly traded partnerships only for taxable years beginning after December 31, 1997.[41] An existing publicly traded partnership is any partnership, if (1) it was a publicly traded partnership on December 17, 1987, (2) a registration statement indicating that the partnership was to be a publicly traded partnership was filed with the Securities and Exchange Commission with respect to the partnership on or before December 17, 1987, or (3) with respect to the partnership, an application was filed with a State regulatory commission on or before December 17, 1987, seeking permission to restructure a portion of a corporation as a publicly traded partnership. A partnership that otherwise would be treated as an existing publicly traded partnership ceases to be so treated as of the first day after December 17, 1987, on which there has been an addition of a substantial new line of business with respect to such partnership. A rule is provided to coordinate this grandfather rule with the exception to the rule treating the partnership as a corporation applies if 90 percent of the partnership's gross income consists of passive-type income. The coordination rule provides that passive-type income exception applies only after the grandfather rule ceases to apply (whether by passage of time or because the partnership ceases to qualify for the grandfather rule).

House Bill

Under the House bill, in the case of an existing publicly traded partnership that elects under the provision to be subject to a tax on gross income from the active conduct of a trade or business, the rule of present law treating a publicly traded partnership as a corporation does not apply. An existing publicly traded partnership is any publicly traded partnership that is not treated as a corporation, so long as such treatment is not determined under the passive-type income exception of Code section 7704(c)(1). The election to be subject to the tax on gross trade or business income, once made, remains in effect until revoked by the partnership, and cannot be reinstated.

[41] Omnibus Budget Reconciliation Act of 1987 (P.L. 100–203) (the "1987 Act"), sec. 10211(c).

The tax is 15 percent of the partnership's gross income from the active conduct of a trade or business. The partnership's gross trade or business income includes its share of gross trade or business income of any lower-tier partnership. The tax imposed under the provision may not be offset by tax credits.

Effective date.—Taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill, except that the tax is 3.5 percent of the partnership's gross income from the active conduct of a trade or business.

Conference Agreement

The conference agreement follows the Senate amendment, with technical modifications. The conference agreement clarifies that the provision applies to any electing 1987 partnership, which means any publicly traded partnership, if (1) it is an existing partnership within the meaning of section 10211(c)(2) of the 1987 Act, (2) it has not been treated as a corporation for taxable years beginning after December 31, 1987, and before January 1, 1998 (and would not have been treated as a corporation even without regard to section 7704(c), the exception for partnerships with "passive-type" income), and (3) the partnership elects under the provision to be subject to a tax on gross income from the active conduct of a trade or business. An electing 1987 partnership ceases to be treated as such as of the first day after December 31, 1997, on which there has been the addition of a substantial new line of business with respect to the partnership.

5. Exclusion from UBIT for certain corporate sponsorship payments (sec. 955 of the House bill and sec. 763 of the Senate amendment)

Present Law

Although generally exempt from Federal income tax, tax-exempt organizations are subject to the unrelated business income tax ("UBIT") on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511–514). Contributions or gifts received by tax-exempt organizations generally are not subject to the UBIT. However, present-law section 513(c) provides that an activity (such as advertising) does not lose its identity as a separate trade or business merely because it is carried on within a larger complex of other endeavors.[42] If a tax-exempt organization receives sponsorship payments in connection with an event or other activity, the solicitation and receipt of such sponsorship payments may be treated as a separate activity. The Internal Reve-

[42] See *United States* v. *American College of Physicians,* 475 U.S. 834 (1986)(holding that activity of selling advertising in medical journal was not substantially related to the organization's exempt purposes and, as a separate business under section 513(c), was subject to tax).

nue Service (IRS) has taken the position that, under some circumstances, such sponsorship payments are subject to the UBIT.[43]

House Bill

Under the House bill, qualified sponsorship payments received by a tax-exempt organization (or State college or university described in section 511(a)(2)(B)) are exempt from the UBIT.

"Qualified sponsorship payments" are defined as any payment made by a person engaged in a trade or business with respect to which the person will receive no substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of the person's trade or business in connection with the organization's activities.[44] Such a use or acknowledgment does not include advertising of such person's products or services—meaning qualitative or comparative language, price information or other indications of savings or value, or an endorsement or other inducement to purchase, sell, or use such products or services. Thus, for example, if, in return for receiving a sponsorship payment, an organization promises to use the sponsor's name or logo in acknowledging the sponsor's support for an educational or fundraising event conducted by the organization, such payment will not be subject to the UBIT. In contrast, if the organization provides advertising of a sponsor's products, the payment made to the organization by the sponsor in order to receive such advertising will be subject to the UBIT (provided that the other, present-law requirements for UBIT liability are satisfied).

The House bill specifically provides that a qualified sponsorship payment does not include any payment where the amount of such payment is contingent, by contract or otherwise, upon the level of attendance at an event, broadcast ratings, or other factors indicating the degree of public exposure to an activity. However, the fact that a sponsorship payment is contingent upon an event actually taking place or being broadcast, in and of itself, will not cause the payment to fail to be a qualified sponsorship payment. Moreover, mere distribution or display of a sponsor's products by the sponsor or the tax-exempt organization to the general public at a sponsored event, whether for free or for remuneration, will be considered to be "use or acknowledgment" of the sponsor's product lines (as opposed to advertising), and thus will not affect the determination of whether a payment made by the sponsor is a qualified sponsorship payment.

The provision does not apply to the sale of advertising or acknowledgments in tax-exempt organization periodicals. For this purpose, the term "periodical" means regularly scheduled and printed material published by (or on behalf of) the payee organization that is not related to and primarily distributed in connection

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[43] See Prop.Treas. Reg. sec. 1.513–4 (issued January 19, 1993, EE–74–92, IRB 1993–7, 71). These proposed regulations generally exclude from the UBIT financial arrangements under which the tax-exempt organization provides so-called "institutional" or "good will" advertising to a sponsor (i.e., arrangements under which a sponsor's name, logo, or product line is acknowledged by the tax-exempt organization). However, specific product advertising (e.g., "comparative or qualitative descriptions of the sponsor's products") provided by a tax-exempt organization on behalf of a sponsor is not shielded from the UBIT under the proposed regulations.

[44] In determining whether a payment is a qualified sponsorship payment, it is irrelevant whether the sponsored activity is related or unrelated to the organization's exempt purpose.

with a specific event conducted by the payee organization. For example, the provision will not apply to payments that lead to acknowledgments in a monthly journal, but will apply if a sponsor receives an acknowledgment in a program or brochure distributed at a sponsored event.

The provision specifically provides that, to the extent that a portion of a payment would (if made as a separate payment) be a qualified sponsorship payment, such portion of the payment will be treated as a separate payment. Thus, if a sponsorship payment made to a tax-exempt organization entitles the sponsor to both product advertising *and* use or acknowledgment of the sponsor's name or logo by the organization, then the UBIT will not apply to the amount of such payment that exceeds the fair market value of the product advertising provided to the sponsor. Moreover, the provision of facilities, services or other privileges by an exempt organization to a sponsor or the sponsor's designees (e.g., complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) in connection with a sponsorship payment will not affect the determination of whether the payment is a qualified sponsorship payment. Rather, the provision of such goods or services will be evaluated as a separate transaction in determining whether the organization has unrelated business taxable income from the event. In general, if such services or facilities do not constitute a substantial return benefit or if the provision of such services or facilities is a related business activity, then the payments attributable to such services or facilities will not be subject to the UBIT. Moreover, just as the provision of facilities, services or other privileges by a tax-exempt organization to a sponsor or the sponsor's designees (complimentary tickets, pro-am playing spots in golf tournaments, or receptions for major donors) will be treated as a separate transaction that does not affect the determination of whether a sponsorship payment is a qualified sponsorship payment, a sponsor's receipt of a license to use an intangible asset (e.g., trademark, logo, or designation) of the tax-exempt organization likewise will be treated as separate from the qualified sponsorship transaction in determining whether the organization has unrelated business taxable income.

The exemption provided by the provision will be in addition to other present-law exceptions from the UBIT (e.g., the exceptions for activities substantially all the work for which is performed by volunteers and for activities not regularly carried on). No inference is intended as to whether any sponsorship payment received prior to 1998 was subject to the UBIT.

Effective date.—The provision applies to qualified sponsorship payments solicited or received after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment, except that the conference agreement clarifies that the qualified sponsorship payment provision does not apply to payments that entitle the payor to the use or acknowledgment of the payor's trade or business name or logo (or product lines) in tax-exempt organization periodicals. Similarly, the qualified sponsorship payment provision does not apply to payments made in connection with "qualified convention or trade show activities," as defined in present-law section 513(d)(3). Such payments are outside the qualified sponsorship payment provision's safe-harbor exclusion, and, therefore, will be governed by present-law rules that determine whether the payment is subject to the UBIT. Thus, for example, payments that entitle the payor to a depiction of the payor's name or logo in a tax-exempt organization periodical may or may not be subject to the UBIT depending on the application of present-law rules regarding periodical advertising and nontaxable donor recognition.[45]

As a further clarification, the conferees intend that, as provided under Prop. Treas. Reg. sec. 1.513–4, the use of promotional logos or slogans that are an established part of the sponsor's identity would not, by itself, constitute advertising for purposes of determining whether a payment is a qualified sponsorship payment.

6. Timeshare associations (sec. 956 of the House bill and sec. 764 of the Senate amendment)

Present Law

Taxation of homeowners associations making the section 528 election.—Under present law (sec. 528), condominium management associations and residential real estate management associations may elect to be taxable at a 30-percent rate on their "homeowners association income" if they meet certain income, expenditure, and organizational requirements.

"Homeowners association income" is the excess of the association's gross income, excluding "exempt function income," over allowable deductions directly connected with nonexempt function gross income. "Exempt function income" includes membership dues, fees, and assessments for a common activity undertaken by association members or owners of residential units in the condominium or subdivision. Homeowners association income includes passive income (e.g., interest and dividends) earned on reserves and fees for use of association property (e.g., swimming pools, meeting rooms, etc.).

For an association to qualify for this treatment: (1) at least 60 percent of the association's gross income must consist of membership dues, fees, or assessments on owners; (2) at least 90 percent of its expenditures must be for the acquisition, management, maintenance, or care of "association property;" and (3) no part of its net

[45] For guidance regarding the treatment of periodical advertising under the UBIT, see section 513(c); *United States* v. *American College of Physicians,* 475 U.S. 834 (1986); Treas. Reg. 1.513–1(d)(4)(iv), Example 7; Rev. Rul. 82–139, 1982–2 C.B. 108; Rev. Rul. 74–38, 1974–1 C.B. 144; PLR 9137049; and PLR 9234002. For guidance regarding the treatment of donor acknowledgments under the UBIT, see Rev. Rul. 76–93, 1976–1 C.B. 170; PLR 8749085; and PLR 9044071. In the interest of administrative convenience, the conferees encourage the Treasury Department to permit tax-exempt entities to provide combined reporting of payments that are both qualified sponsorship payments and nontaxable payments made in exchange for donor acknowledgments in a periodical or in connection with a qualified convention or trade show. In addition, to the extent tax-exempt entities are required to allocate portions of payments, the conferees encourage the Treasury Department to minimize the reporting burden associated with any such allocation.

earnings can inure to the benefit of any private shareholder. "Association property" means: (1) property held by the association; (2) property commonly held by association members; (3) property within the association privately held by association members; and (4) property held by a governmental unit for the benefit of association members. In addition to these statutory requirements, Treasury regulations require that the units of the association be used for residential purposes. Use is not a residential use if the unit is occupied by a person or series of persons less than 30 days for more than half of the association's taxable year. Treas. Reg. sec. 1.528–4(d).

Taxation of homeowners associations not making the section 528 election.—Homeowners associations that do not (or cannot) make the section 528 election are taxed either as a tax-exempt social welfare organization under section 501(c)(4) or as a regular C corporation. In order for an organization to qualify as a tax-exempt social welfare organization, the organization must meet the following three requirements: (1) the association must serve a "community" which bears a reasonable, recognizable relationship to an area ordinarily identified as a governmental subdivision or unit; (2) the association may not conduct activities directed to exterior maintenance of any private residence, and (3) common areas of association facilities must be for the use and enjoyment of the general public (Rev. Rul. 74–99, 1974–1 C.B. 131).

Non-exempt homeowners associations are taxed as C corporations, except that: (1) the association may exclude excess assessments that it refunds to its members or applies to the subsequent year's assessments (Rev. Rul. 70–604, 1970–2 C.B. 9); (2) gross income does not include special assessments held in a special bank account (Rev. Rul. 75–370, 75–2 C.B. 25); and (3) assessments for capital improvements are treated as non-taxable contributions to capital (Rev. Rul. 75–370, 1975–2 C.B. 25).

Taxation of timeshare associations.—Under present law, timeshare associations are taxed as regular C corporations because (1) they cannot meet the requirement of the Treasury regulations for the section 528 election that the units be used for residential purposes (i.e., the 30-day rule) and they have relatively large amount of services performed for its owners (e.g., maid and janitorial services) and (2) they cannot meet any of requirements of Rev. Rul. 74–99 for tax-exempt status under section 501(c)(4).

House Bill

In general.—The House bill amends section 528 to permit timeshare associations to qualify for taxation under that section. Timeshare associations will have to meet the requirements of section 528 (e.g., the 60-percent gross income, 90-percent expenditure, and the non-profit organizational and operational requirements). Timeshare associations electing to be taxed under section 528 are subject to a tax on their "timeshare association income" at a rate of 32 percent.

60-percent test.—A qualified timeshare association must receive at least 60 percent of its income from membership dues, fees and assessments from owners of either (a) timeshare rights to use of, or (b) timeshare ownership in, property the timeshare association.

90-percent test.—At least 90 percent of the expenditures of the timeshare association must be for the acquisition, management, maintenance, or care of "association property," and activities provided by the association to, or on behalf of, members of the timeshare association. "Activities provided to or on behalf of members of the [timeshare] association" includes events located on association property (e.g., member's meetings at the association's meeting room, parties at the association's swimming pool, golf lessons on association's golf range, transportation to and from association property, etc.).

Organizational and operational tests.—No part of the net earnings of the timeshare association can inure to the benefit (other than by acquiring, constructing, or providing management, maintenance, and care of property of the timeshare association or rebate of excess membership dues, fees, or assessments) of any private shareholder or individual. A member of a qualified timeshare association must hold a timeshare right to use (or timeshare ownership in) real property of the association. A qualified timeshare association cannot be a condominium management association. Lastly, the timeshare association must elect to be taxed under section 528.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment provides that association property includes property in which a timeshare association or members of the association have rights arising out of recorded easements, covenants, and other recorded instruments to use property related to the timeshare project.

Effective date.—The provision applies to taxable years beginning after December 31, 1996.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Deferral of gain on certain sales of farm product refiners and processors (sec. 958 of the House bill)

Present Law

Under present law, if certain requirements are satisfied, a taxpayer may defer recognition of gain on the sale of qualified securities to an employee stock ownership plan ("ESOP") or an eligible worker-owned cooperative to the extent that the taxpayer reinvests the proceeds in qualified replacement property (sec. 1042). Gain is recognized when the taxpayer disposes of the qualified replacement property. One of the requirements that must be satisfied for deferral to apply is that, immediately after the sale, the ESOP must own at least 30 percent of the stock of the corporation issuing the qualified securities. In general, qualified securities are securities issued by a domestic C corporation that has no stock outstanding that is readily tradeable on an established securities market. Deferral treatment does not apply to gain on the sale of qualified securities by a C corporation.

House Bill

The House bill extends the deferral provided under section 1042 to the sale of stock of a qualified refiner or processor to an eligible farmer's cooperative. A qualified refiner or processor is a domestic corporation substantially all of the activities of which consist of the active conduct of the trade or business of refining or processing agricultural or horticultural products and which purchases more than one-half of such products to be refined or processed from farmers who make up the cooperative which is purchasing the stock of the cooperative. An eligible farmers' cooperative is an organization which is treated as a cooperative for Federal income tax purposes and which is engaged in the marketing of agricultural or horticultural products.

The deferral of gain is available only if, immediately after the sale, the eligible farmers' cooperative owns 100 percent of the qualified refiner or processor. The provision applies even if the stock of the qualified refiner or processor is publicly traded. In addition, the House bill applies to gain on the sale of stock by a C corporation.

Effective date.—The provision applies to sales after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with the modification that the requirement that the refiner or processor purchase more than one-half of the products to be refined or processed from farmers who make up the cooperative which is purchasing the stock or the cooperative must be satisfied for at least one year prior to the sale.

8. Exception from real estate reporting requirements for certain sales of principal residences (sec. 959 of the House bill and secs. 314(c) and 601 of the Senate amendment)

Present Law

Persons who close real estate transactions are required to file information returns with the IRS. These returns, filed on Form 1099S, are required to show the name and address of the seller of the real estate, details with regard to the gross proceeds of the sale, and the portion of any real property tax which is treated as a tax imposed on the purchaser. Code section 6045(e) also provides for reporting whether any financing of the seller was federally-subsidized indebtedness, but Treasury regulations do not currently require the reporting of this information.

House Bill

The House bill excludes sales of personal residences with a gross sales price of $500,000 or less ($250,000 or less in the case of a seller who is not married) from the real estate transaction reporting requirement. In order to be eligible for this exclusion, the person who would otherwise be required to file the information return must obtain written assurances from the seller of the real estate, in a form acceptable to the Secretary of the Treasury, that any gain will be exempt from Federal income tax under section 121(a) and that no financing of the seller was federally-subsidized indebtedness.

Effective date.—The provision is effective with regard to sales or exchanges occurring after the date of enactment.

Senate Amendment

The Senate amendment follows the House bill, with two modifications.

First, the requirement that the person who would otherwise be required to file the information return obtain written assurances that no financing of the seller was federally-subsidized indebtedness does not apply until such time as the Secretary of the Treasury requires this information to be included in information returns reporting real estate transactions.

Second, the Senate amendment does not exclude from the information reporting requirement any sale of a personal residence in the District of Columbia, if such sale is required to be reported for the purpose of verifying eligibility for the D.C. first-time homeowner credit. The Senate amendment separately establishes a credit of $5,000 for first-time home buyers in the District of Columbia. The Senate amendment anticipates that the Secretary of the Treasury will require such information as is necessary to verify eligibility for the D.C. first-time home buyer credit.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment with one modification, allowing the Secretary of the Treasury the discretion to increase the dollar thresholds if he determines that such an increase will not materially reduce revenues to the Treasury.

9. Increased deduction for business meals for individuals operating under Department of Transportation hours of service limitations (sec. 960 of the House bill and sec. 765 of the Senate amendment)

Present Law

Ordinary and necessary business expenses, as well as expenses incurred for the production of income, are generally deductible, subject to a number of restrictions and limitations. Generally, the amount allowable as a deduction for food and beverage is limited to 50 percent of the otherwise deductible amount. Exceptions to this 50 percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs.

House Bill

The House bill increases to 80 percent the deductible percentage of the cost of food and beverages consumed while away from home by an individual during, or incident to, a period of duty subject to the hours of service limitations of the Department of Transportation.

Individuals subject to the hours of service limitations of the Department of Transportation include:

(1) certain air transportation employees such as pilots, crew, dispatchers, mechanics, and control tower operators pursuant to Federal Aviation Administration regulations,

(2) interstate truck operators and interstate bus drivers pursuant to Department of Transportation regulations,

(3) certain railroad employees such as engineers, conductors, train crews, dispatchers and control operations personnel pursuant to Federal Railroad Administration regulations, and

(4) certain merchant mariners pursuant to Coast Guard regulations.

The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in—	*Deductible percentage*
1998, 1999	55
2000, 2001	60
2002, 2003	65
2004, 2005	70
2006, 2007	75
2008 and thereafter	80

Effective date.—The provision is effective for taxable years beginning after 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

10. Deductibility of meals provided for the convenience of the employer and provided by remote seafood processors (secs. 765 and 778 of the Senate amendment)

Present Law

In general, subject to several exceptions, only 50 percent of business meal and entertainment expenses are allowed as a deduction (sec. 274(n)). Under one exception, the value of meals that are excludable from employees' incomes as a de minimis fringe benefit (sec. 132) are fully deductible by the employer.

In addition, the courts that have considered the issue have held that if meals are provided for the convenience of the employer pursuant to section 119 they are fully deductible pursuant to section 274(n)(2)(B) provided they satisfy the relevant section 132 requirements. (*Boyd Gaming Corp.* v. *Commissioner*[46] and *Gold Coast Hotel & Casino* v. *I.R.S.*[47]).

Exceptions to this 50-percent rule are also provided for food and beverages provided to crew members of certain vessels and off-shore oil or gas platforms or drilling rigs.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that meals that are excludable from employees' incomes because they are provided for the convenience of the employer pursuant to section 119 of the Code are excludable as a de minimis fringe benefit and therefore are fully deductible by the employer, provided they satisfy the relevant section 132 requirements. No inference is intended as to whether such meals are fully deductible under present law.

The Senate amendment also increases to 80 percent the deductible percentage of the cost of food and beverages consumed by workers at remote seafood processing facilities located in the United States north of 53 degrees north latitude. A seafood processing facility is remote when there are insufficient eating facilities in the vicinity of the employer's premises.[48]

The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in—	*Deductible percentage*
1998, 1999	55
2000, 2001	60
2002, 2003	65
2004, 2005	70
2006, 2007	75
2008 and thereafter	80

Effective dates.—The provisions are effective for taxable years beginning after 1997.

Conference Agreement

The conference agreement follows the Senate amendment as to meals provided pursuant to section 119. Because food and beverages consumed by workers at these specified remote seafood processing facilities are provided for the convenience of the employer pursuant to section 119 and therefore will be deductible under the Senate amendment provision as to meals provided pursuant to section 119 (provided they satisfy the relevant section 132 requirements), the conference agreement does not include the Senate amendment provision relating to remote seafood processors because it is subsumed by the section 119 provision.

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[46] 106 T.C. No. 19 (May 23, 1996).
[47] U.S.D.C. Nev. CV–5–94–1146–HDM(LRL) (September 26, 1996).
[48] See Treas. Reg. Sec. 1.119–1(a)(2)(ii)(c) and 1.119–1(f) (Example 7).

11. Deduction of traveling expenses while working away from home on qualified construction projects (sec. 775 of the Senate amendment)

Present Law

A taxpayer is allowed, subject to limitations, to deduct the ordinary and necessary expenses of carrying on a trade or business, including the trade or business of being an employee. Expenses of carrying on the trade or business of being an employee are miscellaneous itemized deductions, deductible only to the extent they exceed 2 percent of adjusted gross income.

Deductible expenses include travel expenses (including amounts expended for meals and lodging) while temporarily away from home in pursuit of a trade or business. In the absence of facts and circumstances indicating otherwise, a taxpayer is considered to be temporarily away from home if the period of employment away from home does not exceed one year. If the period of employment away from home exceeds one year, the taxpayer is considered to be on an indefinite or permanent work assignment, and travel expenses (including amounts expended for meals and lodging) are not deductible.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that, in the absence of facts and circumstances indicating otherwise, taxpayers employed on qualified construction projects will be considered to be temporarily away from home if the period of their employment away from home does not exceed 18 months (24 months if the qualified construction project is in a remote location), rather than one year as under present law. A qualified construction project is one that is identifiable and that has a completion date that is reasonably expected to occur within five years of its starting date. A qualified construction project is considered to be in a remote location if it is located in an area which lacks adequate housing, educational, medical or other facilities necessary for families.

These revised standards for workers on qualified construction projects apply only to taxpayers who continue to maintain a household, and therefore incur duplicative expenses, at their place of principal residence.

Effective date.—The provision is effective for amounts paid or incurred in taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

12. Provide above-the-line deduction for certain business expenses (sec. 766 of the Senate amendment)

Present Law

Under present law, individuals may generally deduct ordinary and necessary business expenses in determining adjusted gross income ("AGI"). This deduction does not apply in the case of an individual performing services as an employee. Employee business expenses are generally deductible only as a miscellaneous itemized deduction, i.e., only to the extent all the taxpayer's miscellaneous itemized deductions exceed 2 percent of the taxpayer's AGI. Employee business expenses are not allowed as a deduction for alternative minimum tax purposes.

House Bill

No provision.

Senate Amendment

Employee business expenses relating to service as an official of a State or local government (or political subdivision thereof) are deductible in computing AGI ("above the line"), provided the official is compensated in whole or in part on a fee basis. Consequently, such expenses are also deductible for minimum tax purposes.

Effective date.—The provision applies to expenses paid or incurred in taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.—The conference agreement is effective with respect to expenses paid or incurred in taxable years beginning after December 31, 1986.

13. Increase in standard mileage rate for purposes of computing charitable deduction (sec. 767 of the Senate amendment)

Present Law

In general, individuals who itemize their deductions may deduct charitable contributions. For purposes of computing the charitable deduction for the use of a passenger automobile, the standard mileage rate is 12 cents per mile (sec. 170(i)).

House Bill

No provision.

Senate Amendment

The Senate amendment increases this mileage rate to 15 cents per mile. This rate is indexed for inflation, rounded down to the nearest whole cent.

Effective date.—The increase to 15 cents is effective for taxable years beginning after December 31, 1997. The indexation is effective for inflation occurring after 1997. Accordingly, the first adjustment for indexing will occur in 1999 to reflect inflation in 1998.

Conference Agreement

The conference agreement increases this mileage rate to 14 cents per mile (not indexed for inflation), effective for taxable years beginning after December 31, 1997.

14. Expensing of environmental remediation costs ("brownfields") (sec. 768 of the Senate amendment)

Present Law

Code section 162 allows a deduction for ordinary and necessary expenses paid or incurred in carrying on any trade or business. Treasury Regulations provide that the cost of incidental repairs which neither materially add to the value of property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted currently as a business expense. Section 263(a)(1) limits the scope of section 162 by prohibiting a current deduction for certain capital expenditures. Treasury Regulations define "capital expenditures" as amounts paid or incurred to materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or to adapt property to a new or different use. Amounts paid for repairs and maintenance do not constitute capital expenditures. The determination of whether an expense is deductible or capitalizable is based on the facts and circumstances of each case.

Treasury regulations provide that capital expenditures include the costs of acquiring or substantially improving buildings, machinery, equipment, furniture, fixtures and similar property having a useful life substantially beyond the current year. In *INDOPCO, Inc.* v. *Commissioner,* 112 S. Ct. 1039 (1992), the Supreme Court required the capitalization of legal fees incurred by a taxpayer in connection with a friendly takeover by one of its customers on the grounds that the merger would produce significant economic benefits to the taxpayer extending beyond the current year; capitalization of the costs thus would match the expenditures with the income produced. Similarly, the amount paid for the construction of a filtration plant, with a life extending beyond the year of completion, and as a permanent addition to the taxpayer's mill property, was a capital expenditure rather than an ordinary and necessary current business expense. *Woolrich Woolen Mills* v. *United States,* 289 F.2d 444 (3d Cir. 1961).

Although Treasury regulations provide that expenditures that materially increase the value of property must be capitalized, they do not set forth a method of determining how and when value has been increased. In *Plainfield-Union Water Co.* v. *Commissioner,* 39 T.C. 333 (1962), nonacq., 1964–2 C.B. 8, the U.S. Tax Court held that increased value was determined by comparing the value of an asset after the expenditure with its value before the condition necessitating the expenditure. The Tax Court stated that "an expenditure which returns property to the state it was in before the situation prompting the expenditure arose, and which does not make the relevant property more valuable, more useful, or longer-lived, is usually deemed a deductible repair."

In several Technical Advice Memoranda (TAM), the Internal Revenue Service (IRS) declined to apply the *Plainfield Union* valuation analysis, indicating that the analysis represents just one of several alternative methods of determining increases in the value of an asset. In TAM 9240004 (June 29, 1992), the IRS required certain asbestos removal costs to be capitalized rather than expensed. In that instance, the taxpayer owned equipment that was manufactured with insulation containing asbestos; the taxpayer replaced the asbestos insulation with less thermally efficient, non-asbestos insulation. The IRS concluded that the expenditures resulted in a material increase in the value of the equipment because the asbestos removal eliminated human health risks, reduced the risk of liability to employees resulting from the contamination, and made the property more marketable. Similarly, in TAM 9411002 (November 19, 1993), the IRS required the capitalization of expenditures to remove and replace asbestos in connection with the conversion of a boiler room to garage and office space. However, the IRS permitted deduction of costs of encapsulating exposed asbestos in an adjacent warehouse.

In 1994, the IRS issued Rev. Rul. 94–38, 1994–1 C.B. 35, holding that soil remediation expenditures and ongoing water treatment expenditures incurred to clean up land and water that a taxpayer contaminated with hazardous waste are deductible. In this ruling, the IRS explicitly accepted the *Plainfield Union* valuation analysis.[49] However, the IRS also held that costs allocable to constructing a groundwater treatment facility are capital expenditures.

In 1995, the IRS issued TAM 9541005 (October 13, 1995) requiring a taxpayer to capitalize certain environmental study costs, as well as associated consulting and legal fees. The taxpayer acquired the land and conducted activities causing hazardous waste contamination. After the contamination, but before it was discovered, the company donated the land to the county to be developed into a recreational park. After the county discovered the contamination, it reconveyed the land to the company for $1. The company incurred the costs in developing a remediation strategy. The IRS held that the costs were not deductible under section 162 because the company acquired the land in a contaminated state when it purchased the land from the county. In January, 1996, the IRS revoked and superseded TAM 9541005 (PLR 9627002). Noting that the company's contamination of the land and liability for remediation were unchanged during the break in ownership by the county, the IRS concluded that the break in ownership should not, in and of itself, operate to disallow a deduction under section 162.

House Bill

No provision.

[49] Rev. Rul. 94–38 generally rendered moot the holding in TAM 9315004 (December 17, 1992) requiring a taxpayer to capitalize certain costs associated with the remediation of soil contaminated with polychlorinated biphenyls (PCBs).

Senate Amendment

The Senate amendment provides that taxpayers could elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site. In general, any expenditure for the acquisition of depreciable property used in connection with the abatement or control of hazardous substances at a qualified contaminated site does not constitute a qualified environmental remediation expenditure. However, depreciation deductions allowable for such property which would otherwise be allocated to the site under the principles set forth in *Comm'r* v. *Idaho Power Co.*[50] and section 263A are treated as qualified environmental remediation expenditures.

A "qualified contaminated site" generally is any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). Targeted areas would mean (1) empowerment zones and enterprise communities (as designated under present law, including any supplemental zone designated on December 21, 1994); and (2) sites announced before February, 1997, as being subject to one of the 76 Environmental Protection Agency (EPA) Brownfields Pilots.

Both urban and rural sites qualify. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) cannot be targeted areas. Appropriate State environmental agencies are designated by the EPA; if no State agency is designated, the EPA is responsible for providing the certification. Hazardous substances generally are defined by reference to sections 101(14) and 102 of CERCLA, subject to additional limitations applicable to asbestos and similar substances within buildings, certain naturally occurring substances such as radon, and certain other substances released into drinking water supplies due to deterioration through ordinary use.

The Senate amendment further provides that, in the case of property to which a qualified environmental remediation expenditure otherwise would have been capitalized, any deduction allowed under the bill would be treated as a depreciation deduction and the property would be treated as subject to section 1245. Thus, deductions for qualified environmental remediation expenditures would be subject to recapture as ordinary income upon sale or other disposition of the property.

Effective date.—The provision applies to eligible expenditures incurred after the date of enactment.

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[50] *Comm'r* v. *Idaho Power Co.*, 418 U.S. 1 (1974) (holding that equipment depreciation allocable to the taxpayer's construction of capital facilities must be capitalized under section 263(a)(1)).

Conference Agreement

The conference agreement follows the Senate amendment, except that the definition of "targeted areas" is expanded to include population census tracts with a poverty rate of 20 percent or more and certain industrial and commercial areas that are adjacent to such census tracts. Thus, targeted areas generally would include: (1) empowerment zones and enterprise communities as designated under present law and under the conference agreement[51] (including any supplemental empowerment zone designated on December 21, 1994); (2) sites announced before February 1997, as being subject to one of the 76 Environmental Protection Agency (EPA) Brownfields Pilots; (3) any population census tract with a poverty rate of 20 percent or more; and (4) certain industrial and commercial areas that are adjacent to tracts described in (3) above.

With respect to certification of targeted areas, the conference agreement provides that the chief executive officer of a State may, in consultation with the Administrator of the EPA, designate an appropriate State environmental agency. If no State environmental agency is so designated within 60 days of the date of enactment, the appropriate environmental agency for such State shall be designated by the Administrator of the EPA.

In addition, the conference agreement sunsets the provision after three years. Thus, the provision applies only to eligible expenditures incurred in taxable years ending after date of enactment and before January 1, 2001.

Finally, the conferees wish to clarify that providing current deductions for certain environmental remediation expenditures under the conference agreement creates no inference as to the proper treatment of other remediation expenditures not described in the agreement.

15. Treatment of consolidation of certain mutual savings bank life insurance departments (sec. 962 of the House bill)

Present Law

Special rules for mutual savings banks with life insurance business

Present law provides for special treatment of a mutual savings bank conducting a life insurance business in a separate life insurance department (Code sec. 594). Under the special rule, the insurance and noninsurance businesses of such banks are bifurcated, and the tax imposed is the sum of the partial taxes computed on (a) the taxable income of the mutual savings bank determined without regard to items properly allocable to the life insurance business, and (b) the income of the life insurance department, calculated in accordance with the rules applicable to life insurance companies (subchapter L of the Code). This special treatment applies so long as the mutual savings bank is authorized under State law to engage in the business of issuing life insurance contracts,

[51] Thus, the 20 additional empowerment zones authorized to be designated under the conference agreement as well as the D.C. Enterprise Zone established under the conference agreement are "targeted areas" for purposes of this provision.

the life insurance business is conducted in a separate department the accounts of which are maintained separately from the other accounts of the mutual savings bank, and the life insurance department would qualify as a life insurance company under Code section 816 if it were treated as a separate corporation.

Rules for corporate reorganizations

Present law provides that certain corporate reorganization transactions, including recapitalizations, generally are treated as tax-free transactions (sec. 368(a)(1)(E)). No gain or loss is recognized if stock or securities in a corporation that is a party to a reorganization are (in pursuance of the plan of reorganization) exchanged solely for stock or securities in that corporation or in another corporation that is a party to the reorganization, except that gain (if any) to the recipient is recognized to the extent the principal amount of securities received exceeds the principal amount of the securities surrendered (secs. 354, 356(a)(1)). If such an exchange has the effect of distribution of a dividend, then the portion of the distributee's gain that does not exceed his ratable share of the corporation's earnings and profits is treated as a dividend (sec. 356(a)(2)).

Rules for life insurance companies

A life insurance company generally is permitted to deduct the amount of policyholder dividends paid or accrued during the taxable year (sec. 808). In the case of a mutual life insurance company, the amount of the deduction for policyholder dividends is reduced (but not below zero) by the differential earnings amount (sec. 809). The term policyholder dividend includes (1) any amount paid or credited (including as an increase in benefits) if the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management; (2) excess interest; (3) premium adjustments; and (4) experience-rated refunds.

House Bill

The House bill provides that the consolidation of two or more life insurance departments of mutual savings banks into a single life insurance company by requirement of State law is treated as a tax-free reorganization described in section 368(a)(1)(E) (i.e., a recapitalization). Any payments required to be made to policyholders in connection with the consolidation are treated as policyholder dividends deductible by the company under section 808, provided that certain requirements are met. The requirements are: (1) the payments are only with respect to policies in effect immediately before the consolidation; (2) the payments are only with respect to policies that are participating (i.e., on which policyholder dividends are paid) before and after the consolidation; (3) the payments cease with respect to any policy if the policy lapses after the consolidation; (4) the policyholders before the consolidation had no divisible right to the surplus of any life insurance department and had no right to vote; and (5) the approval of the policyholders was not required for the consolidation. No inference is intended as to the tax treatment of (1) consolidation, demutualization or other transactions involving, or (2) payments to policyholders of, any insurer or financial institution other than the life insurance departments of mutual savings banks.

Effective date.—The provision takes effect on December 31, 1991.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

16. Offset of past-due, legally enforceable State tax obligations against Federal overpayments (sec. 963 of the House bill)

Present Law

Overpayments of Federal tax are credited against any liability in respect of an internal revenue tax on the part of the person who made the overpayment. Any overpayment not so credited may be offset against any past-due support payments and past-due legally enforceable debts owed to Federal agencies of the person making the overpayment. Any remaining overpayment is refunded to the person making the overpayment.

House Bill

The House bill provides that an overpayment of Federal tax could be offset by the amount of any past-due, legally enforceable State tax obligation, provided the person making the overpayment has shown on the return establishing the overpayment an address that is within the State seeking the offset. For this purpose, a past-due, legally enforceable State tax obligation is a debt which resulted from a judgement rendered by a court of competent jurisdiction, or a determination after an administrative hearing, which determined an amount of State tax to be due and which is no longer subject to judicial review, as well as from an assessment the time for which redetermination has expired that has not been delinquent for more than 10 years. A State tax obligation includes any local tax administered by the chief tax administration agency of the State.

The offset for a past-due, legally enforceable State tax obligation of a State resident will apply after the offsets provided in present law for internal revenue tax liabilities, past-due support, and past-due, legally enforceable obligations owed a Federal agency.

The Secretary of the Treasury is authorized to issue regulations establishing procedures for the implementation of this proposal, including regulations prescribing the time and manner in which States may submit notices of past-due, legally enforceable State tax obligations. The Secretary of the Treasury may require States to pay a fee to reimburse the Secretary for the cost of applying the offset procedure.

Effective date.—The provision is effective for refunds payable after December 31, 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

17. Modify limits on depreciation of luxury automobiles for certain clean-burning fuel and electric vehicles (sec. 964 of the House bill)

Present Law

The amount the taxpayer may claim as a depreciation deduction for any passenger automobile is limited to: $2,560 for the first taxable year in the recovery period; $4,100 for the second taxable year in the recovery period; $2,450 for the third taxable year in the recovery period; and $1,475 for each succeeding taxable year in the recovery period. Each of the dollar limitations is indexed for inflation after October 1987 by automobile component of the Consumer Price Index. Consequently, the limitations applicable for 1997 are $3,160, $5,000, $3,050, and $1,775.

House Bill

The House bill modifies the present-law limitation on depreciation in the case of qualified clean-burning fuel vehicles and certain electric vehicles. With respect to qualified clean-burning fuel vehicles, those that are modified to permit such vehicle to be propelled by a clean burning fuel, the bill generally modifies present-law by applying the current limitation to that portion of the vehicles cost not represented by the installed qualified clean-burning fuel property. The taxpayer may claim an amount otherwise allowable as a depreciation deduction on the installed qualified clean-burning fuel, without regard to the present-law limitation. Generally, this has the same effect as only subjecting the cost of the vehicle before modification to the present-law limitations.

In the case of a passenger vehicle designed to be propelled primarily by electricity and built by an original equipment manufacturer, the base-year limitation amounts of $2,560 for the first taxable year in the recovery period, $4,100 for the second taxable year in the recovery period, $2,450 for the third taxable year in the recovery period, and $1,475 for each succeeding taxable year in the recovery period are tripled to $7,680, $12,300, $7,350, and $4,425, respectively, and then adjusted for inflation after October 1987 by the automobile component of the Consumer Price Index.

Effective date.—The provision is effective for property placed in service on or after the date of enactment and before January 1, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to the effective date that provides that the provision is effective for property placed in service after the date of enactment and before January 1, 2005.

18. Survivor benefits of public safety officers killed in the line of duty (sec. 965 of the House bill and sec. 784 of the Senate amendment)

Present Law

Survivors of military service personnel (such as those killed in combat) are generally entitled to survivor benefits (38 U.S.C. sec. 1310). These survivor benefits are generally exempt from income taxation (38 U.S.C. sec. 5301). "Survivor" means the surviving spouse or surviving dependent child of the military service personnel.

Survivor annuity benefits paid under a governmental retirement plan to a survivor of a law enforcement officer killed in the line of duty are generally includible in income except to the extent the benefits are a return of after-tax employee contributions. Survivor benefits paid under a government plan only to survivors of officers who died as a result of injuries sustained in the line of duty are in the nature of workers" compensation and are generally excludable from income.

House Bill

The House bill generally provides that an amount paid as a survivor annuity on account of the death of a law enforcement officer who is killed in the line of duty is excludable from income to the extent the survivor annuity is attributable to the officer's service as a law enforcement officer. The survivor annuity must be provided under a governmental plan to the surviving spouse (or former spouse) of the law enforcement officer or to a child of the officer.

Effective date.—The provision applies to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

Senate Amendment

The Senate amendment is the same as the House bill except that the provision applies to public safety officers killed in the line of duty. Public safety officers include law enforcement officers, firefighters, rescue squad or ambulance crew.

Conference Agreement

The conference agreement follows the Senate amendment. The conference agreement clarifies that the provision does not apply with respect to the death of a public safety officer if it is determined by the appropriate supervising authority that (1) the death was caused by the intentional misconduct of the officer or by the officers intention to bring about the death, (2) the officer was voluntarily intoxicated at the time of death, (3) the officer was performing his or her duties in a grossly negligent manner at the time of death, or (4) the actions of the individual to whom payment is to be made were a substantial contributing factor to the death of the officer.

19. Temporary suspension of income limitations on percentage depletion for production from marginal wells (sec. 966 of the House bill and sec. 772 of the Senate amendment)

Present Law

The Code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. In the case of certain properties, the deductions may be determined using the percentage depletion method. Certain limitations apply in calculating percentage depletion deductions. One limitation is a restriction that these deductions may not exceed 65 percent of the taxpayer's taxable income. Another limitation is a restriction that the amount deducted may not exceed 100 percent of the net income from that property in any year.

Specific percentage depletion rules apply to oil and gas production from "marginal" properties. Marginal production is defined as domestic crude oil and natural gas production from stripper well property or from property from which substantially all of the production during the calendar year is heavy oil. Stripper well property is property from which the average daily production is 15 barrel equivalents or less, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for the calendar year by the number of wells.

House Bill

The 65-percent-of-net-income limitation is suspended for domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The 100-percent-of-net-income property limitation with respect to oil and gas produced from marginal properties does not apply for any taxable year beginning in a calendar year in which the annual average wellhead price for crude oil (within the meaning of section 29(d)(2)(C)) is below $14 per barrel.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The 100-percent-of-net-income property limitation is suspended for domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

Effective date.—The provision is effective on the date of enactment.

20. Extend production credit for electricity produced from wind and "closed loop" biomass (sec. 771 of the Senate amendment)

Present Law

An income tax credit is allowed for the production of electricity from either qualified wind energy or qualified "closed-loop" biomass facilities. The credit is equal to 1.5 cents (plus adjustments for inflation since 1992) per kilowatt hour of electricity produced from these qualified sources during the 10-year period after the facility is placed in service.

The credit applies to electricity produced by qualified wind or closed-loop biomass facilities placed in service before July 1, 1999. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the income tax credit for electricity produced from wind and closed-loop biomass for two years. Thus, the credit is available for qualifying electricity produced from facilities placed in service before July 1, 2001. As under present law, the credit is allowable for a period of 10 years after the facility is placed in service.

Effective date.—The provision is effective as of the date of enactment.

Conference Agreement

The conference agreement does not include the provision in the Senate amendment.

21. Modification of advance refunding rules for certain tax-exempt bonds issued by the Virgin Islands (sec. 957 of the House bill)

Present Law

Advance refundings

Generally, a governmental bond originally issued after December 31, 1985, may be advance refunded one time. An advance refunding is any refunding where all of the refunded bonds are not redeemed within 90 days after the refunding bonds are issued.

Virgin Island bonds

Under present law, the Virgin Islands is required to secure its bonds with a priority first lien claim on specified revenue streams rather than being permitted to issue multiple bond issues secured on a parity basis by a common pool of revenues. Under a proposed non-tax law change, the priority lien requirement would be repealed.

House Bill

Under the House bill, one additional advance refunding would be allowed for governmental bonds issued by the Virgin Islands that were advance refunded before June 9, 1997, if the Virgin Islands debt provisions are changed to repeal the current priority first lien requirement.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

22. Qualified small-issue bonds (sec. 770 of the Senate amendment)

Present Law

Interest on certain small issues of private activity bonds issued by State or local governments ("qualified small-issue bonds") is excluded from gross income if certain conditions are met. First, at least 95 percent of the bond proceeds must be used to finance manufacturing facilities or certain agricultural land or equipment. Second, the bond issue must have an aggregate face amount of $1 million or less, or alternatively, the aggregate face amount of the issue, together with the aggregate amount of certain related capital expenditures during the six-year period beginning three years before the date of the issue and ending three years after that date, must not exceed $10 million. (The maximum face amount of bonds would not be increased over present-law amounts.)

Issuance of qualified small-issue bonds, like most other private activity bonds, is subject to annual State volume limitations and to other rules.

House Bill

No provision.

Senate Amendment

The Senate amendment increases the maximum capital expenditure limit under present law from $10 million to $20 million. The maximum amount of bonds is not increased over present-law amounts.

Effective date.—The provision is effective for bonds issued after December 31, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

23. Treatment of bonds issued by the Federal Home Loan Bank Board under the Federal guarantee rules (sec. 774 of the Senate amendment)

Present Law

Generally, interest on bonds which are Federally guaranteed do not qualify for tax-exemption for Federal income tax purposes. Certain exceptions are provided including otherwise qualifying bonds guaranteed by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Government National Mortgage Association.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, bonds guaranteed by the Federal Home Loan Bank Board are not treated as Federally guaranteed for purposes of the Federal guarantee prohibition generally applicable to tax-exempt bonds.

Effective date.—The provision is effective for bonds issued after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

24. Current refundings of certain bonds issued by Indian tribal governments (sec. 789 of the Senate amendment)

Present Law

Indian tribal governments are permitted to issue tax-exempt bonds for essential government functions. Since 1987, this term has been defined to include only those activities that traditionally are carried out as governmental functions by State governments.

Before 1987, some Indian tribes issued tax-exempt bonds to acquire existing businesses as investments. Under present law, tax-exempt bonds may not be issued for this purpose, and outstanding pre-1987 bonds issued for such acquisitions may not be refunded.

House Bill

No provision.

Senate Amendment

The Senate amendment allows pre-1987 tax-exempt bonds issued by Indian tribal governments for business acquisitions to be refunded if:

(1) the refunded bonds are redeemed within 90 days after the refunding bonds are issued;

(2) the outstanding principal amount of the bonds is not increased; and

(3) the maturity date of the bonds is not extended.

Effective date.—The provision applies to bonds issued after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

25. Purchasing of receivables by tax-exempt hospital cooperative service organizations (sec. 773 of the Senate amendment)

Present Law

Section 501(e) provides that an organization organized on a cooperative basis by tax-exempt hospitals will itself be tax-exempt if the organization is operated solely to perform, on a centralized basis, one or more of certain enumerated services for its members. These services are: data processing, purchasing (including the purchase of insurance on a group basis), warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel services. An organization does not qualify under section 501(e) if it performs services other than the enumerated services. (Treas. reg. sec. 1.501(e)(–1(c)).

House Bill

No provision.

Senate Amendment

The Senate amendment clarifies that, for purposes of section 501(e), billing and collection services include the purchase of patron accounts receivable on a recourse basis. Thus, hospital cooperative service organizations are permitted to advance cash on the basis of member accounts receivable, provided that each member hospital retains the risk of non-payment with respect to its accounts receivable.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996. No inference is intended with respect to taxable years prior to the effective date.

Conference Agreement

The conference agreement follows the Senate amendment.

26. Charitable contribution deduction for certain expenses incurred in support of Native Alaskan subsistence whaling (sec. 776 of the Senate amendment)

Present Law

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity (sec. 170). Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization, contributions to which are deductible, may constitute a deductible contribution (Treas. Reg. sec. 1.170A–1(g)). Specifically, section 170(j) provides that no charitable contribution deduction is allowed for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

House Bill

No provision.

Senate Amendment

The Senate amendment allows individuals to claim a deduction under section 170 not exceeding $7,500 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities. The deduction is available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction is available for reasonable and necessary expenses paid by the taxpayer during the taxable year for (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities, (2) the supplying of food for the crew and other provisions for carrying out such activities, and (3) storage and distribution of the catch from such activities.

For purposes of the provision, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission. No inference is intended regarding the deductibility of any whaling expenses incurred in a taxable year ending before the date of enactment.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

27. Designation of additional empowerment zones; modification of empowerment zone and enterprise community criteria (sec. 777 of the Senate amendment)

Present Law

In general

Pursuant to the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993), the Secretaries of the Department of Housing and Urban Development (HUD) and the Department of Agriculture designated a total of nine empowerment zones and 95 enterprise communities on December 21, 1994. As required by law, six empowerment zones are located in urban areas (with aggregate population for the six designated urban empowerment zones limited to 750,000) and three empowerment zones are located in rural areas.[52] Of the enterprise communities, 65 are located in urban areas and 30 are located in rural areas (sec. 1391). Designated empowerment zones and enterprise communities were required to satisfy certain eligibility criteria, including specified poverty rates and population and geographic size limitations (sec. 1392).

The following tax incentives are available for certain businesses located in empowerment zones: (1) A 20-percent wage credit for the first $15,000 of wages paid to a zone resident who works in the zone; (2) an additional $20,000 of section 179 expensing for "qualified zone property" placed in service by an "enterprise zone business" (accordingly, certain businesses operating in empowerment zones are allowed up to $38,000 of expensing for 1997); and (3) special tax-exempt financing for certain zone facilities (described in more detail below).

The 95 enterprise communities are eligible for the special tax-exempt financing benefits but not the other tax incentives available in the nine empowerment zones. In addition to these tax incentives, OBRA 1993 provided that Federal grants would be made to designated empowerment zones and enterprise communities.

The tax incentives for empowerment zones and enterprise communities generally will be available during the period that the designation remains in effect, i.e., a 10-year period.

Definition of "qualified zone property"

Present-law section 1397C defines "qualified zone property" as depreciable tangible property (including buildings), provided that: (1) The property is acquired by the taxpayer (from an unrelated party) after the zone or community designation took effect; (2) the original use of the property in the zone or community commences with the taxpayer; and (3) substantially all of the use of the property is in the zone or community in the active conduct of a trade or business by the taxpayer in the zone or community. In the case of property which is substantially renovated by the taxpayer, however, the property need not be acquired by the taxpayer after zone or community designation or originally used by the taxpayer within

[52] The six designated urban empowerment zones are located in New York City, Chicago, Atlanta, Detroit, Baltimore, and Philadelphia-Camden (New Jersey). The three designated rural empowerment zones are located in Kentucky Highlands (Clinton, Jackson, and Wayne counties, Kentucky), Mid-Delta Mississippi (Bolivar, Holmes, Humphreys, Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

the zone or community if, during any 24-month period after zone or community designation, the additions to the taxpayer's basis in the property exceed 100 percent of the taxpayer's basis in the property at the beginning of the period, or $5,000 (whichever is greater).

Definition of "enterprise zone business"

Present-law section 1397B defines the term "enterprise zone business" as a corporation or partnership (or proprietorship) if for the taxable year: (1) The sole trade or business of the corporation or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community; (2) at least 80 percent of the total gross income is derived from the active conduct of a "qualified business" within a zone or community; (3) substantially all of the business's tangible property is used within a zone or community; (4) substantially all of the business's intangible property is used in, and exclusively related to, the active conduct of such business; (5) substantially all of the services performed by employees are performed within a zone or community; (6) at least 35 percent of the employees are residents of the zone or community; and (7) no more than five percent of the average of the aggregate unadjusted bases of the property owned by the business is attributable to (a) certain financial property, or (b) collectibles not held primarily for sale to customers in the ordinary course of an active trade or business.

A "qualified business" is defined as any trade or business other than a trade or business that consists predominantly of the development or holding of intangibles for sale or license.[53] In addition, the leasing of real property that is located within the empowerment zone or community to others is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property to others is not a qualified business unless substantially all of the rental of such property is by enterprise zone businesses or by residents of an empowerment zone or enterprise community.

Tax-exempt financing rules

Tax-exempt private activity bonds may be issued to finance certain facilities in empowerment zones and enterprise communities. These bonds, along with most private activity bonds, are subject to an annual private activity bond State volume cap equal to $50 per resident of each State, or (if greater) $150 million per State.

Qualified enterprise zone facility bonds are bonds 95 percent or more of the net proceeds of which are used to finance (1) "qualified zone property" (as defined above) the principal user of which is an "enterprise zone business" (also defined above[54]), or (2) functionally related and subordinate land located in the empowerment zone or

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[53] Also, a qualified business does not include certain facilities described in section 144(c)(6)(B) (e.g., massage parlor, hot tub facility, or liquor store) or certain large farms.

[54] For purposes of the tax-exempt financing rules, an "enterprise zone business" also includes a business located in a zone or community which would qualify as an enterprise zone business if it were separately incorporated.

enterprise community. These bonds may only be issued while an empowerment zone or enterprise community designation is in effect.

The aggregate face amount of all qualified enterprise zone bonds for each qualified enterprise zone business may not exceed $3 million per zone or community. In addition, total qualified enterprise zone bond financing for each principal user of these bonds may not exceed $20 million for all zones and communities.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the present-law empowerment zone and enterprise community designation criteria under section 1392 so that, in the event that additional empowerment zones or enterprise communities are authorized to be designated in the future, any zones or communities designated in the States of Alaska or Hawaii will not be subject to the general size limitations under section 1392(a)(3), nor will such zones or communities be subject to the general poverty-rate criteria under section 1392(a)(4). Instead, nominated areas in either State will be eligible for designation as an empowerment zone or enterprise community if, for each census tract or block group within such area, at least 20 percent of the families have incomes which are 50 percent or less of the State-wide median family income. Such zones and communities will be subject to the population limitations under present-law section 1392(a)(1).

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment. In addition, the conference agreement provides for the designation of 20 additional empowerment zones pursuant to slightly expanded eligibility criteria, and includes certain modifications to the definition of an enterprise zone business and the tax-exempt financing rules.

Two additional empowerment zones with same tax incentives as previously designated empowerment zones

Under the conference agreement, the Secretary of HUD is authorized to designate two additional empowerment zones located in urban areas (thereby increasing to eight the total number of empowerment zones located in urban areas) with respect to which generally apply the same tax incentives (i.e., the wage credit, additional expensing, and special tax-exempt financing) as are available within the empowerment zones authorized by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993). The wage credit available in the two new urban empowerment zones is modified slightly to provide that the percentage of wages taken into account for purposes of determining the wage credit is 20 percent for 2000–2004, 15 percent for 2005, 10 percent for 2006, and 5 percent for 2007.

No wage credit is available in the two new urban empowerment zones after 2007.

The two additional empowerment zones are subject to the same eligibility criteria under present-law section 1392 that applies to the original six urban empowerment zones. In order to permit designation of these two additional empowerment zones, the conference agreement increases the present-law 750,000 aggregate population cap applicable to empowerment zones located in urban areas to a cap of 1,000,000 aggregate population for the eight urban empowerment zones.

The two empowerment zones must be designated within 180 days after the date of enactment. However, the designations will not take effect before January 1, 2000, and generally will remain in effect for 10 years.

Designation of additional empowerment zones

The conference agreement authorizes the Secretaries of HUD and Agriculture to designate an additional 20 empowerment zones (no more than 15 in urban areas and no more than five in rural areas).[55] With respect to these additional empowerment zones, the present-law eligibility criteria are expanded slightly. First, the square mileage limitations of present law (i.e., 20 square miles for urban areas and 1,000 for rural areas) are expanded to allow the empowerment zones to include an additional 2,000 acres. This additional acreage, which could be developed for commercial or industrial purposes, is not subject to the poverty rate criteria and could be divided among up to three noncontiguous parcels. In addition, the present-law requirement that at least half of the nominated area consist of census tracts with poverty rates of 35 percent or more does not apply. Thus, under present-law section 1392(a)(4), at least 90 percent of the census tracts within a nominated area must have a poverty rate of 25 percent or more, and the remaining census tracts must have a poverty rate of 20 percent or more.[56] For this purpose, census tracts with populations under 2,000 are treated as satisfying the 25-percent poverty rate criteria if (1) at least 75 percent of the tract is zoned for commercial or industrial use and (2) the tract is contiguous to one or more other tracts that actually have a poverty rate of 25 percent or more.

Within the 20 additional empowerment zones, qualified "enterprise zone businesses" are eligible to receive up to $20,000 of additional section 179 expensing[57] and to utilize special tax-exempt financing benefits. The "brownfields" tax incentive provided under the conference agreement also is available within all designated empowerment zones. Businesses within the 20 additional empowerment zones are *not,* however, eligible to receive the present-law wage credit available within the 11 other designated empowerment zones (i.e., the wage credit would be available only

[55] Under the conference agreement, areas located within Indian reservations are eligible for designation as empowerment zones.

[56] In lieu of the poverty criteria, outmigration may be taken into account in designating one rural empowerment zone.

[57] However, the additional section 179 expensing is *not* available within the additional 2,000 acres allowed to be included under the conference agreement within an empowerment zone.

in the nine present-law zones and two new urban empowerment zones designated under the conference agreement).

The 20 additional empowerment zones are required to be designated before 1999, and the designations generally will remain in effect for 10 years.

Modification of definition of enterprise zone business

The conference agreement modifies the present-law requirement of section 1397B that an entity may qualify as an "enterprise zone business" only if (in addition to the other present-law criteria) at least 80 percent of the total gross income of such entity is derived from the active conduct of a qualified business within an empowerment zone or enterprise community. The conference agreement liberalizes this present-law requirement by reducing the percentage threshold so that an entity could qualify as an enterprise zone business if at least 50 percent of the total gross income of such entity is derived from the active conduct of a qualified business within an empowerment zone or enterprise community (assuming that the other criteria of section 1397B are satisfied).

In addition, section 1397B is modified so that rather than requiring that "substantially all" tangible and intangible property (and employee services) of an enterprise zone business be used (and performed) within a designated zone or community, a "substantial portion" of tangible and intangible property (and employee services) of an enterprise zone business would be required to be used (and performed) within a designated zone or community. Moreover, the conference agreement further amends the section 1397B rule governing intangible assets so that a substantial portion of an entity's intangible property must be used in the active conduct of a qualified business within a zone or community, but there is no need (as under present law) to determine whether the use of such assets is "exclusively related to" such business. However, the present-law rule of section 1397B(d)(4) continues to apply, such that a "qualified business" would not include any trade or business consisting predominantly of the development or holding or intangibles for sale or license. The conference agreement also clarifies that an enterprise zone business that leases to others commercial property within a zone or community may rely on a lessee's certification that the lessee is an enterprise zone business. Finally, the conference agreement provides that the rental to others of tangible personal property shall be treated as a qualified business if and only if at least 50 percent of the rental of such property is by enterprise zone businesses or by residents of a zone or community (rather than the present-law requirement that "substantially all" tangible personal property rentals of an enterprise zone business satisfy this test).

This modified "enterprise zone business" definition applies to all previously designated empowerment zones and enterprise communities, the two urban empowerment zones designated under the conference agreement, as well as to the 20 additional empowerment zones authorized to be designated pursuant to the conference agreement.[58]

Tax-exempt financing rules

Exceptions to volume cap

The conference agreement allows "new empowerment zone facility bonds" to be issued for qualified enterprise zone businesses in the 20 additional empowerment zones. These bonds are not subject to the State private activity bond volume caps or the special limits on issue size applicable to qualified enterprise zone facility bonds under present law. The maximum amount of these bonds that can be issued is limited to $60 million per rural zone, $130 million per urban zone with a population of less than 100,000, and $230 million per urban zone with a population of 100,000 or more.

Changes to certain rules applicable to both empowerment zone facility bonds and qualified enterprise community facility bonds

Qualified enterprise zone businesses located in newly designated empowerment zones, as well as those located in previously designated empowerment zones and enterprise communities, would be eligible for special tax-exempt bond financing under present-law rules, subject to the modifications described below (and the exception to the volume cap described above for newly designated empowerment zones).

The conference agreement waives until the end of a "startup period" the requirement that 95 percent or more of the proceeds of bond issue be used by a qualified enterprise zone business. With respect to each property, the startup period ends at the beginning of the first taxable year beginning more than two years after the later of (1) the date of the bond issue financing such property, or (2) the date the property was placed in service (but in no event more than three years after the date of bond issuance). This waiver is only available if, at the beginning of the startup period, there is a reasonable expectation that the use by a qualified enterprise zone business would be satisfied at the end of the startup period and the business makes bona fide efforts to satisfy the enterprise zone business definition.

The conference agreement also waives the requirements of an enterprise zone business (other than the requirement that at least 35 percent of the business' employees be residents of the zone or community) for all years after a prescribed testing period equal to first three taxable years after the startup period.

Finally, the conference agreement relaxes the rehabilitation requirement for financing existing property with qualified enterprise zone facility bonds. In the case of property which is substantially renovated by the taxpayer, the property need not be acquired by the taxpayer after zone or community designation or originally used by the taxpayer within the zone if, during any 24-month period after zone or community designation, the additions to the tax-

[58] In addition, the modifications to the enterprise zone business definition will apply for purposes of defining a "D.C. Zone business" under certain provisions of the conference agreement that provide certain tax incentives for the District of Columbia.

payer's basis in the property exceeded 15 percent of the taxpayer's basis at the beginning of the period, or $5,000 (whichever is greater).

Effective date

The two additional urban empowerment zones (within which generally are available the same tax incentives as are available in the empowerment zones designated pursuant to OBRA 1993) must be designated within 180 days after enactment, but the designation will not take effect before January 1, 2000. The 20 additional empowerment zones (within which the wage credit is not available) are to be designated after enactment but prior to January 1, 1999. For purposes of the additional section 179 expensing available within empowerment zones, the modifications to the definition of "enterprise zone business" are effective for taxable years beginning on or after the date of enactment.

The changes to the tax-exempt financing rules are effective for qualified enterprise zone facility bonds and the new empowerment zone facility bonds issued after the date of enactment.

28. Conducting of certain games of chance not treated as unrelated trade or business (sec. 783 of the Senate amendment)

Present Law

Although generally exempt from Federal income tax, tax-exempt organizations are subject to the unrelated business income tax (UBIT) on income derived from a trade or business regularly carried on that is not substantially related to the performance of the organization's tax-exempt functions (secs. 511–514).[59] Certain income, however, is exempted from the UBIT (such as interest, dividends, royalties, and certain rents), unless derived from debt-financed property (sec. 512(b)). Other exemptions from the UBIT are provided for activities in which substantially all the work is performed by volunteers and for income from the sale of donated goods (sec. 513(a)).

A specific exemption from the UBIT is provided for certain bingo games[60] conducted by tax-exempt organizations, provided that the conducting of the bingo games is not an activity ordinarily carried out on a commercial basis and the conducting of which does not violate any State or local law (sec. 513(f)).[61] In addition, a spe-

[59] The UBIT applies not only to private, tax-exempt entities but also to colleges and universities that are agencies or instrumentalities of (or are owned or operated by) a State or local government or Indian tribal government (secs. 511(a)(2)(B) and 7871(a)(5)). In the case of such a college or university, the "substantially related" test is applied by determining whether the trade or business activity at issue is substantially related to the exercise or performance of any purpose or function described in section 501(c)(3) (see sec. 513(a)).

[60] For purposes of this exemption, the term "bingo game" is defined as any game of bingo of a type in which usually (1) the wagers are placed, (2) the winners are determined, and (3) the distribution of prizes or other property is made in the presence of all persons placing wagers in such game (sec. 513(f)(2)). See *Julius M. Israel Lodge of B'nai B'rith v. Comm'r,* No. 96–60087 (Fifth Cir., October 25, 1996) (holding that "instant bingo" game did not fall within sec. 513(f) exemption, because each player's participation in the game is wholly independent of any other's and requires only that the player remove a pull-tab to determine whether he or she has a winning card).

[61] In 1978, at the same time that Congress enacted section 513(f), section 527 was modified to provide that bingo income of political organizations is to be treated as "exempt function in-

Continued

cific exemption from the UBIT is provided for qualified public entertainment activities (meaning entertainment or recreation activities of a kind traditionally conducted at fairs or expositions promoting agricultural and educational purposes) conducted by an organization described in section 501 (c)(3), (c)(4), or (c)(5) which regularly conducts an agricultural and educational fair or exposition as one of its substantial exempt purposes (sec. 513(d)).[62]

In *South End Italian Independent Club, Inc. v. Commissioner,* 87 T.C. 168 (1986), *acq.* 1987–2 C.B. 1, the Tax Court held that gambling profits of a social club described in section 501(c)(7) that were required by State law to be used for charitable purposes were fully deductible under section 162 in computing the UBIT liability of the social club. The effect of this decision was to exempt gambling income of that social club from UBIT. The IRS has indicated that, until further guidance is available with respect to this issue, the issue of the deductibility of amounts required under State law to be used for charitable or other so-called "lawful" purposes should be resolved consistent with the *South End* case, regardless of whether the gaming proceeds are donated to other charitable organizations or spent internally on the organization's own charitable activities.[63]

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the UBIT will not apply to income from a "qualified game of chance," meaning any game of chance (other than a bingo game exempt under present-law sec. 513(f)) conducted by a tax-exempt organization if (1) such organization is licensed pursuant to State law to conduct such game, (2) only organizations which are organized as nonprofit corporations or are exempt from Federal income tax under section 501(a) may be so licensed to conduct such game within the State, and (3) the conduct of such game does not violate State or local law.

No inference is intended regarding the treatment for purposes of the UBIT of games of chance conducted by tax-exempt organizations prior to the date of enactment.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

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come" and, thus, not subject to Federal income tax if such income is used for certain political purposes (sec. 527(c)(3)(D)).

[62] In addition, section 311 of the Deficit Reduction Act of 1984 (as modified by the Tax Reform Act of 1986) provides a special, off-Code exemption from the UBIT for games of chance conducted by nonprofit organizations in the State of North Dakota.

[63] See IRS, *Exempt Organizations: Technical Instruction Program for FY 1996* (Training 4277–048 (7–95)) at page 96.

29. Exclusion from income of certain severance payments (sec. 788(a) of the Senate amendment)

Present Law

Severance payments are includible in income.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, certain severance payments are excludable from income. The provision applies to payments of up to $2,000 received by an individual who was separated from service in connection with a reduction in the work force of the employer and who does not attain employment within 6 months of the separation from service at a compensation level that is at least 95 percent of the compensation the individual was receiving before the separation from service. The exclusion does not apply if the total separation payments received by the individual exceed $125,000.

Effective date.—The provision applies to taxable years beginning after December 31, 1997, and before July 1, 2002.

Conference Agreement

The conference agreement does not include the Senate amendment.

30. Special rule for thrift institutions that became large banks (sec. 790 of the Senate amendment)

Present Law

A provision of the Small Business Job Protection Act of 1996 repealed the percentage-of-taxable-income method of determining bad debt deductions of thrift institutions for taxable years beginning after 1995. A large bank (i.e., one with assets in excess of $500 million as of the end of its 1995 taxable year) that was required to change its method of accounting by reason of the provision generally is required to recapture its post-1987 bad debt reserve over a 6-year period. The amount of recapture for a small bank generally is reduced to the extent the bank's reserve for bad debts determined under the experience method applicable to such institutions exceeded its pre-1988 reserve.

House Bill

No provision.

Senate Amendment

The Senate amendment allows a thrift institution that first became a large bank in its first taxable year beginning after 1994 to be treated as a small bank for purposes of the Small Business Job Protection Act provision. In addition, such institutions may apply the required change in accounting method on a cut-off basis.

Effective date.—The provision is effective as if included in the Small Business Job Protection Act of 1996.

Conference Agreement

The conference agreement does not include the Senate amendment.

31. Income averaging for farmers (sec. 792 of the Senate amendment)

Present Law

The ability for an individual taxpayer to reduce his or her tax liability by averaging his or her income over a number of years was repealed by the Tax Reform Act of 1986.

House Bill

No provision.

Senate Amendment

An individual taxpayer is allowed to elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or a portion of his or her taxable income from the trade of business of farming.

Effective date.—The provision is effective for taxable years beginning after the date of enactment and before January 1, 2001.

Conference Agreement

The conference agreement includes the Senate amendment with modifications. The conference agreement clarifies that the provision operates such that an electing eligible taxpayer (1) designates all or a portion of his or her taxable income from the trade or business of farming from the current year as "elected farm income;" (2) allocates one-third of such "elected farm income" to each of the prior three taxable years; and (3) determines his or her current year section 1 tax liability by determining the sum of (a) his or her current year section 1 liability without the elected farm income allocated to the three prior taxable years plus (b) the increases in the section 1 tax for each of the three prior taxable years by taking into account the allocable share of the elected farm income for such years. If a taxpayer elects the operation the provision for a taxable year, the allocation of elected farm income among taxable years pursuant to the election shall apply for purposes of any election in a subsequent taxable year.

The provision does not apply for employment tax purposes, or to an estate or a trust. Further, the provision does not apply for purposes of the alternative minimum tax under section 55. Finally, the provision does not require the recalculation of the tax liability of any other taxpayer, including a minor child required to use the tax rates of his or her parents under section 1(g).

The election shall be made in the manner prescribed by the Secretary of the Treasury and, except as provided by the Secretary, shall be irrevocable. In addition, the Secretary of the Treasury shall prescribe such regulations as are necessary to carry out the purposes of the provision, including regulations regarding the order and manner in which items of income, gain, deduction, loss, and credits (and any limitations thereon) are to be taken into account for purposes of the provision and the application of the provision to any short taxable year. It is expected that such regulations will deny the multiple application of items that carryover from one taxable year to the next (e.g., net operating loss or tax credit carryovers).

The provision applies to taxable years beginning after December 31, 1997, and before January 1, 2001.

32. Intercity Passenger Rail Fund; Elective carryback of existing net operating losses of the National Railroad Passenger Corporation (Amtrak) (sec. 702 of the Senate amendment)

Present Law

In addition to current transportation-related trust fund fuels excise taxes, there is a permanent 4.3-cents-per-gallon General Fund excise tax on transportation fuels.

Generally, net operating losses may be carried back to the three taxable years preceding the year of loss (10 taxable years preceding the year of loss in certain circumstances).

House Bill

No provision.

Senate Amendment

The Senate amendment dedicates net revenues from 0.5 cent per gallon of the 4.3-cents-per gallon transportation motor fuels excise tax to a new Intercity Passenger Rail Fund ("Rail Fund") to finance capital improvements of National Railroad Passenger Corporation (Amtrak) and certain transportation activities in States not receiving Amtrak service. Dedicated revenues are those from fuels taxes imposed from October 1, 1997 through April 15, 2001.

The Senate amendment also expands the purposes for which non-Amtrak States may use Rail Fund monies to include: (1) local transit needs such as transportation for the elderly and handicapped; (2) rail/highway crossing safety projects (generally financed through the Highway Trust Fund); (3) certain capital expenditures of smaller freight railroads; and (4) certain rural airport capital expenditures.

Amounts received from the Rail Fund are not included in income. No tax deduction or addition to basis is allowed by the recipient with respect to expenditure of the amount.

Rail Fund spending is subject to appropriation, and is provided for under provisions of the Fiscal Year 1998 Budget Resolution.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the approach of the Senate amendment with modifications. The conference agreement provides elective procedures that allows Amtrak to consider the tax attributes of its predecessors, those railroads that were relieved of their responsibility to provide intercity rail passenger service as a result of the Rail Passenger Service Act of 1970, in the use of its net operating losses. The benefit allowable under these procedures is limited to the least of: (1) 35 percent of Amtrak's existing qualified carryovers, (2) the net tax liability for the carryback period, or (3) $2,323,000,000. One half of the amount so calculated will be treated as a payment of the tax imposed by chapter 1 of the Internal Revenue Code of 1986 for each of the first two taxable years ending after the date of enactment.

The existing qualified carryovers are the net operating loss carryovers that are available under section 172(b) in Amtrak's first taxable year ending after September 30, 1997. The net tax liability for the carryback period is the aggregate of the net tax liability of Amtrak's railroad predecessors for all taxable years beginning before January 1, 1971, for which there is a net Federal tax liability. Amtrak's railroad predecessors are those railroads that were relieved of their responsibility to provide intercity rail passenger service as a result of the Rail Passenger Service Act of 1970, and their predecessors. In the case of a railroad predecessor who joined in the filing of a consolidated tax return, the net tax liability of the predecessor will be the net tax liability of the consolidated group.

The net operating losses of Amtrak are required to be reduced by an amount equal to the amount obtained by Amtrak under this provision, divided by 0.35. The Secretary of the Treasury is to adjust, as he deems appropriate, the tax account of each predecessor railroad for the carryback period to reflect the utilization of the net operating losses. The amount of the adjustment is equal to the amount of the benefit and is to be taken into consideration on the tax accounts of the predecessor railroads on a first-in, first-out basis, starting with balances for the earliest year for which any predecessor railroad has a net tax liability. No additional refund to any taxpayer other than Amtrak is to be allowed as a result of these adjustments.

The availability of the elective procedures is conditioned on Amtrak (1) agreeing to make payments of one percent (1%) of the amount it receives to each of the non-Amtrak States to offset certain transportation related expenditures and (2) using the balance for certain qualified expenses. Non-Amtrak States are those States that are not receiving Amtrak service at any time during the period beginning on the date of enactment and ending on the date of payment.

No deduction is allowed with respect to any qualified expense whose payment is attributable to the proceeds made available as a result of this provision. The basis of any property must be reduced by the portion of its cost that is attributable to such proceeds. An item of cost or expense is attributable to such proceeds if it is (1) paid from the proceeds of the refund or (2) to the extent the principal and interest of any borrowings are paid from the proceeds of the refund, from the proceeds of such borrowings.

Amtrak's earnings and profits will be increased by the amount of the refund. However, the conferees expect that this amount will not be included in adjusted current earnings for alternative minimum tax purposes, consistent with Treas. Reg. sec. 1.56(g)–1(c)(4)(ii).

Effective date.—The provision is effective on the date of enactment. However, no refund shall be made as a result of this provision earlier than the date of enactment of Federal legislation which authorizes reforms of Amtrak. No interest shall accrue with respect to the payment of any refund until 45 days after the later of (1) the enactment of such reform legislation, or (2) the filing by Amtrak of a Federal income tax return which includes the election to use the procedures described in this provision.

X. REVENUE-INCREASE PROVISIONS

A. Financial Products

1. Require recognition of gain on certain appreciated financial positions in personal property (sec. 1001(a) of the House bill and sec. 801(a) of the Senate amendment)

Present Law

In general, gain or loss is taken into account for tax purposes when realized. Gain or loss generally is realized with respect to a capital asset at the time the asset is sold, exchanged, or otherwise disposed of. Special rules under the Code can defer or accelerate recognition in certain circumstances. Transactions designed to reduce or eliminate risk of loss, such as a "short sale against the box," or an "equity swap," generally do not cause realization.

House Bill

The House bill requires recognition of gain (but not loss) upon a constructive sale of any "appreciated financial position" in stock, a partnership interest or debt other than certain "straight" debt instruments (as defined in sec. 1361(c)(5)(B)). A constructive sale occurs when the taxpayer enters into one of the following transactions with respect to the same or substantially identical property: (1) a short sale, (2) an offsetting notional principal contract, or (3) a futures or forward contact. For a taxpayer who has one of these transactions, a constructive sale occurs when it acquires the related long position. Other transactions will be treated as constructive sales to the extent provided in Treasury regulations.

The House bill provides an exception for transactions that are closed before the end of the 30th day after the close of the taxable year. This exception does not apply to transactions closed during the 90-day period ending on such day unless, for the 60 days after closing, (1) the taxpayer holds the appreciated financial position and (2) at no time is the taxpayer's risk of loss reduced by holding certain other positions.

Effective date.—The constructive sale provision is effective for constructive sales entered into after June 8, 1997. In the case of a decedent dying after June 8, 1997, if (1) a constructive sale occurred before such date, (2) the transaction remains open for not less than two years, and (3) the transaction is not closed in a taxable transaction within 30 days after the date of enactment, all positions comprising the constructive sale will be treated as property constituting rights to receive income in respect of a decedent under section 691. A special rule is also provided for transactions entered into before June 8, 1997, that in some circumstances prevents such transactions from resulting in constructive sales after the effective date.

Senate Amendment

The Senate amendment is the same as the House bill with two modifications. Under the Senate amendment, the types of debt instruments excluded from the definition of "appreciated financial position" are instruments that are not convertible and the interest on which is either fixed, payable at certain variable rates or based on certain interest payments on a pool of mortgages. In addition, the Senate amendment provides an exception for transactions closed during the 90-day period ending on the 30th day after the close of the taxable year that are reestablished during such period, so long as the normal requirements for positions closed within such 90-day period are met by the reestablished position.

Conference Agreement

The conference agreement follows the Senate amendment with the following modifications.

A trust instrument that is actively traded is generally treated as stock for purposes of determining whether the instrument is an appreciated financial position. The conference agreement provides that a trust instrument will not be treated as stock if substantially all (by value) of the property held by the trust is debt that qualifies for the exception to the definition of appreciated financial position for certain debt instruments. In addition, the conference agreement clarifies that only debt instruments that entitle the holder to receive an unconditional principal amount qualify for the exception.

The conference agreement modifies the exception to constructive sale treatment for transactions that are closed in the 90-day period ending with the 30th day after the close of the taxable year by applying similar requirements to all transactions closed prior to such day. Under the conference agreement, the exception is available only if, for the 60 days after closing a transaction, (1) the taxpayer holds the appreciated financial position and (2) at no time is the taxpayer's risk of loss reduced by holding certain other positions. If a transaction that is closed is reestablished in a substantially similar position, the exception applies provided that the reestablished position is closed prior to the end of the 30th day after the close of the taxable year and the above two requirements are met after such closing.

The conferees also wish to clarify some aspects of the application of the provision. The conferees do not intend that an agreement that is not a contract for purposes of applicable contract law will be treated as a forward contract. Thus, contingencies to which the contract is subject will generally be taken into account.

The conferees intend that the constructive sale provision generally will apply to transactions that are identified hedging or straddle transactions under other Code provisions (secs. 1092 (a)(2), (b)(2) and (e), 1221 and 1256(e)). Where either position in such an identified transaction is an appreciated financial position and a constructive sale of such position results from the other position, the conferees intend that the constructive sale will be treated as having occurred immediately before the identified transaction. The constructive sale will not, however, prevent qualification of the transaction as an identified hedging or straddle transaction. Where, after the establishment of such an identified transaction, there is a constructive sale of either position in the transaction, gain will generally be recognized and accounted for under the relevant hedging or straddle provision. However, the conferees intend that future Treasury regulations may except certain transactions from the constructive sale provision where the gain recognized would be deferred under an identified hedging or straddle provision (e.g. Treas. reg. sec. 1.446–4(b)).

The conferees wish to clarify certain other aspects of the Treasury's regulatory authority under the provision. The conferees urge that the Treasury issue prompt guidance, including safe harbors, with respect to common transactions entered into by taxpayers.

The legislative history to both the House bill and the Senate amendment describe "collar" transactions and recommend that Treasury regulations provide standards for determining which collar transactions result in constructive sales. The conferees expect that these Treasury regulations with respect to collars will be applied prospectively, except in cases to prevent abuse.

The legislative history states that, under the regulations to be issued by the Treasury, either a taxpayer's appreciated financial position or an offsetting transaction may in certain circumstances be considered on a disaggregated basis for purposes of the constructive sale determination. The conferees wish to clarify that this authority is intended to be used only where such disaggregated treatment reflects the economic reality of the transaction and is administratively feasible. For example, one transaction for which disaggregated treatment might be appropriate is an equity swap that references a small group of stocks, where the transaction is entered into by a taxpayer owning only one of the stocks. [1]

Effective date.—The conference agreement modifies the special rule for decedents dying after June 8, 1997, to require that a position be open at some time during the three-year period ending on the decedent's death. Thus, no amount will be treated as income in respect of a decedent under the rule unless this requirement is met, as well as the requirements that the transaction remains open for not less than two years and that the transaction is not closed within 30 days after the date of enactment. Finally, the conference agreement modifies the special rule to provide that gain with respect to a position that accrues after the transaction is closed will not be included in income in respect of a decedent.

[1] A standard similar to that of Treas. reg. sec. 1.246–5 would be appropriate for determining whether the relationship between the stock held and the group of stocks shorted is sufficient for constructive sale purposes.

2. Election of mark-to-market for securities traders and for traders and dealers in commodities (sec. 1001(b) of the House bill and sec. 801(b) of the Senate amendment)

Present Law

A dealer in securities must compute its income pursuant to the mark-to-market method of accounting. Mark-to-market treatment does not apply to traders in securities or dealers in other property.

House Bill

The House bill allows securities traders and commodities traders and dealers to elect mark-to-market accounting similar to that currently required for securities dealers. All securities held by an electing taxpayer in connection with a trade or business as a securities trader, and all commodities held by an electing taxpayer in connection with a trade or business as a commodities dealer or trader, are subject to mark-to-market treatment. Property not held in connection with its trade or business is not subject to the election provided that it is identified by the taxpayer under rules similar to the present law rules for securities dealers. Gain or loss recognized by an electing taxpayer under the provision is ordinary gain or loss.

Under the House bill, commodities for purposes of the provision would include only commodities of a kind customarily dealt in on an organized commodities exchange.

Effective date.—The election applies to taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and Senate amendment with the following modifications.

The conference agreement clarifies that if a securities trader elects application of the provision, all securities held in connection with its trade or business will generally be subject to mark-to-market accounting. An exception is provided for securities that have no connection with activities as a trader and that are identified on the day acquired (or at such other times as provided in Treasury regulations). The conferees do not intend that an electing taxpayer can mark-to-market loans made to customers or receivables or debt instruments acquired from customers that are not received or acquired in connection with a trade or business as a securities trader. Because the conferees are concerned about issues of taxpayer selectivity, the conferees intend that an electing taxpayer must be able to demonstrate by clear and convincing evidence that a security bears no relation to activities as a trader in order to be identified as not subject to the mark-to-market regime. Any security that hedges another security that is held in connection with the taxpayer's trade or business as a trader will be treated as so held. Any position that is properly subject to the mark-to-market regime will not be taken into account for purposes of the constructive sale rules of section 1259. Similar rules apply to commodities traders.

The conference agreement expands the definition of a commodity for purposes of the provision to include any commodity that is actively traded (within the meaning of section 1092(d)(1)), any option, forward contract, futures contract, short position, notional principal contract or derivative instrument that references such a commodity, and any other evidence of an interest in such a commodity. Also included are positions that hedge the listed items and that are identified by the taxpayer under rules similar to the rules for securities.

The conferees anticipate that Treasury regulations applying section 475(b)(4), which prevents a dealer from treating certain notional principal contracts and other derivative financial instruments as held for investment will, in the case of a commodities trader or dealer apply only to contracts and instruments referenced to commodities.

Effective date.—The conferees wish to clarify that the special rule with respect to the section 481 adjustment applies only to taxpayers making the election for the taxable year which includes the date of enactment. Any elections made thereafter will be governed by rules and procedures established by the Secretary of the Treasury.

3. Limitation on exception for investment companies under section 351 (sec. 1002 of the House bill and sec. 802 of the Senate amendment)

Present Law

Gain or loss is recognized upon a contribution by a shareholder to a corporation that is an investment company. Gain, but not loss, is recognized upon a contribution by a partner to a partnership that would be treated as an investment company. Under Treasury regulations, a contribution of property is treated as made to an investment company only if (1) the contribution results, directly or indirectly, in a diversification of the transferor's interest and (2) the transferee is (a) a regulated investment company ("RIC"), (b) a real estate investment trust ("REIT") or (c) a corporation more than 80 percent of the assets of which by value (excluding cash and non-convertible debt instruments) are readily marketable stocks or securities or interests in RICs or REITs that are held for investment

House Bill

The House bill modifies the definition of an investment company by requiring that the following assets also be taken into account for purposes of the 80-percent test: money, financial instruments, foreign currency, and interests in RICs, REITs, common trust funds, publicly-traded partnerships and precious metals. The House bill provides an exception for precious metals that are produced, used or held in an active trade or business by a partnership. The House bill also provides "look through" rules for certain entities that hold the above-listed items.

Effective date.—The provision is effective for transfers after June 8, 1997, in taxable years ending after such date, with an exception for transfers pursuant to certain binding written contracts in effect on that date.

Senate Amendment

The Senate amendment follows the House bill, but clarifies that equity interests in non-corporate entities will be taken into account for purposes of the investment company determination only if (1) the entity is a REIT, publicly-traded partnership or common trust fund, (2) the interest is convertible into or exchangeable for one of the other listed assets or (3) the entity holds listed assets and is subject to the "look-through" rules. The Senate amendment also clarifies that the exception for precious metals used or held in an active trade or business applies to both corporations and partnerships. The Senate amendment deletes the exception for precious metals that are produced by a partnership. The Senate amendment also provides the Treasury with regulatory authority to remove items from the list in appropriate circumstances.

Conference Agreement

The conference agreement is the same as the Senate amendment.

4. Disallowance of interest on indebtedness allocable to tax-exempt obligations (sec. 1003 of the House bill)

Present Law

In general

Present law disallows a deduction for interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is not subject to tax (tax-exempt obligations) (sec. 265). This rule applies to tax-exempt obligations held by individual and corporate taxpayers. The rule also applies to certain cases in which a taxpayer incurs or continues indebtedness and a related person acquires or holds tax-exempt obligations.[2]

Application to non-financial corporations

General guidelines.—In Rev. Proc. 72–18, 1972–1 C.B. 740, the IRS provided guidelines for application of the disallowance provision to individuals, dealers in tax-exempt obligations, other business enterprises, and banks in certain situations. Under Rev. Proc. 72–18, a deduction is disallowed only when indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt obligations.

This purpose may be established either by direct or circumstantial evidence. Direct evidence of a purpose to purchase tax-exempt obligations exists when the proceeds of indebtedness are di-

[2] Code section 7701(f) (as enacted in the Deficit Reduction Act of 1984 (sec. 53(c) of P.L. 98–369)) provides that the Treasury Secretary shall prescribe such regulations as may be necessary or appropriate to prevent the avoidance of any income tax rules which deal with linking of borrowing to investment or diminish risk through the use of related persons, pass-through entities, or other intermediaries.

rectly traceable to the purchase of tax-exempt obligations or when such obligations are used as collateral for indebtedness. In the absence of direct evidence, a deduction is disallowed only if the totality of facts and circumstances establishes a sufficiently direct relationship between the borrowing and the investment in tax-exempt obligations.

Two-percent de minimis exception.—In the case of an individual, interest on indebtedness generally is not disallowed if during the taxable year the average adjusted basis of the tax-exempt obligations does not exceed 2 percent of the average adjusted basis of the individual's portfolio investments and trade or business assets. In the case of a corporation other than a financial institution or a dealer in tax-exempt obligations, interest on indebtedness generally is not disallowed if during the taxable year the average adjusted basis of the tax-exempt obligations does not exceed 2 percent of the average adjusted basis of all assets held in the active conduct of the trade or business. These safe harbors are inapplicable to financial institutions and dealers in tax-exempt obligations.

Interest on installment sales to State and local governments.—If a taxpayer sells property to a State or local government in exchange for an installment obligation, interest on the obligation may be exempt from tax. Present law has been interpreted to not disallow interest on a taxpayer's indebtedness if the taxpayer acquires nonsalable tax-exempt obligations in the ordinary course of business in payment for services performed for, or goods supplied to, State or local governments. [3]

Application to financial corporations and dealers in tax-exempt obligations

In the case of a financial institution, the allocation of the interest expense of the financial institution (which is not otherwise allocable to tax-exempt obligations) is based on the ratio of the average adjusted basis of the tax-exempt obligations acquired after August 7, 1987, to the average adjusted basis of all assets of the taxpayer (sec. 265). In the case of an obligation of an issuer which reasonably anticipates to issue not more than $10 million of tax-exempt obligations (other than certain private activity bonds) within a calendar year (the "small issuer exception"), only 20 percent of the interest allocable to such tax-exempt obligations is disallowed (sec. 291(a)(3)). A similar pro rata rule applies to dealers in tax-exempt obligations, but there is no small issuer exception, and the 20-percent disallowance rule does not apply (Rev. Proc. 72–18).

Treatment of insurance companies

Present law provides that a life insurance company's deduction for additions to reserves is reduced by a portion of the company's income that is not subject to tax (generally, tax-exempt interest and deductible intercorporate dividends) (secs. 807 and 812). The portion by which the life insurance company's reserve deduction is reduced is related to its earnings rate. Similarly, in the case of property and casualty insurance companies, the deduction for

[3] *R.B. George Machinery Co.*, 26 B.T.A. 594 (1932) acq. C.B. XI–2, 4; Rev. Proc. 72–18, as modified by Rev. Proc. 87–53, 1987–2 C.B. 669.

losses incurred is reduced by a percentage (15 percent) of (1) the insurer's tax-exempt interest and (2) the deductible portion of dividends received (with special rules for dividends from affiliates) (sec. 832(b)(5)(B)). If the amount of this reduction exceeds the amount otherwise deductible as losses incurred, the excess is includible in the property and casualty insurer's income.

House Bill

General rule

The House bill extends to all corporations (other than insurance companies) the rule that applies to financial institutions that disallows interest deductions of a taxpayer (that are not otherwise disallowed as allocable under present law to tax-exempt obligations) in the same proportion as the average basis of its tax-exempt obligations bears to the average basis of all of the taxpayer's assets. However, the House bill does not extend the small-issuer exception to taxpayers which are not financial institutions.

Exceptions

The House bill does not apply to nonsalable tax-exempt debt acquired by a corporation in the ordinary course of business in payment for goods or services sold to a State or local government. In addition, the House bill provides a de minimis exception under which the disallowance rule does not apply to corporations, other than financial institutions and dealers in tax-exempt obligations, if the average adjusted basis of tax-exempt obligations acquired after August 7, 1986, is less than the lesser of $1 million or 2 percent of the basis of all of the corporation's assets. Under the House bill, insurance companies are not subject to the pro rata rule but would continue to be subject to present law.

Holdings by related persons

The House bill applies the interest disallowance provision to all related persons that are members of the same consolidated group as if all the members of the group were a single taxpayer. The consolidated group rule is to be applied without regard to any member that is an insurance company. In the case of affiliated corporations that are not members of the same consolidated group, tracing rules apply as if all of the related persons are a single entity.

In the case of a corporation (other than a financial institution) that is a partner in a partnership, the corporate partners are treated as holding their allocable shares of all of the assets of the partnership.

The provision is not intended to affect the application of section 265 to related parties under present law.

Effective date.—The provision is effective for taxable years beginning after the date of enactment with respect to obligations acquired after June 8, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the provision of the House bill.

5. Gains and losses from certain terminations with respect to property (sec. 1004 of the House bill and sec. 803 of the Senate amendment)

Present Law

Extinguishment treated as sale or exchange.—The definition of capital gains and losses in section 1222 requires that there be a "sale or exchange" of a capital asset. Court decisions interpreted this requirement to mean that when a disposition is not a sale or exchange of a capital asset, for example, a lapse, cancellation, or abandonment, the disposition produces ordinary income or loss,[4] Under a special provision, gains and losses attributable to the cancellation, lapse, expiration, or other termination of a right or obligation with respect to certain personal property are treated as gains or losses from the sale of a capital asset (sec. 1234A). Personal property subject to this rule is (1) personal property (other than stock that is not part of straddle or of a corporation that is not formed or availed of to take positions which offset positions in personal property of its shareholders) of a type which is actively traded and which is, or would be on acquisition, a capital asset in the hands of the taxpayer and (2) a "section 1256 contract"[5] which is capital asset in the hands of the taxpayer. Section 1234A does not apply to the retirement of a debt instrument.

Character of gain on retirement of debt obligations.—Amounts received on the retirement of any debt instrument are treated as amounts received in exchange therefor (sec. 1271(a)(1)). In addition, gain on the sale or exchange of a debt instrument with OID[6] generally is treated as ordinary income to the extent of its OID if there was an intention at the time of its issuance to call the debt instrument before maturity (sec. 1271(a)(2)). These rules do not apply to (1) debt issued by a natural person or (2) debt issued before July 2, 1982, by a noncorporate or nongovernment issuer.

House Bill

Extension of relinquishment rule to all types of property.—The House bill extends the rule which treats gain or loss from the cancellation, lapse, expiration, or other termination of a right or obligation which is (or on acquisition would be) a capital asset in the hands of the taxpayer to all types of property.

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[4] See *Fairbanks* v. *U.S.,* 306 U.S. 436 (1039); *Comm'r* v. *Pittston Co.,* 252 F. 2d 344 (2nd Cir.), cert. denied, 357 U.S. 919 (1958).

[5] A "section 1256 contract" means (1) any regulated futures contract, (2) foreign currency contract, (3) nonequity option, or (4) dealer equity option.

[6] The issuer of a debt instrument with OID generally accrues and deducts the discount, as interest, over the life of the obligation even though the amount of such interest is not paid until the debt matures. The holder of such a debt instrument also generally includes the OID in income as it accrues as interest. The mandatory inclusion of OID in income does not apply, among other exceptions, to debt obligations issued by natural persons before March 2, 1984, and loans of less than $10,000 between natural persons if such loan is not made in the ordinary course of business of the lender (secs. 1272(a)(2) (D) and (E)).

Character of gain on retirement of debt obligations issued by natural persons.—The House bill repeals the provision that exempts debt obligations issued by natural persons from the rule which treats gain realized on retirement of the debt as exchanges. Thus, under the House bill, gain or loss on the retirement of such debt will be capital gain or loss if the debt is a capital asset. The House bill retains the present-law exceptions for debt issued before July 2, 1982, by noncorporations or nongovernments.

Effective date.—The extension of the extinguishment rule applies to property acquired or positions established 30 days after the date of enactment. The repeal of the exception to the character of gain on retirement of debt instruments issued by natural persons or obligations issued before July 2, 1982, applies to debt issued or purchased after June 8, 1997.

Senate Amendment

The Senate amendment is the same as the House bill, except for the effective date.

Effective date.—The extension of the extinguishment rule applies to property acquired or positions established 30 days after the date of enactment. The repeal of the exception to the character of gain on retirement of debt instruments issued by natural persons or obligations issued before July 2, 1982, applies to debt issued or purchased (within the meaning of section 1272(d)(1)) after June 8, 1997. Thus, the repeal of the exception to the character of gain on retirement of debt instruments issued by natural persons or obligations issued before July 2, 1982, does not apply to transfers after June 8, 1997, where the basis of the debt instrument to the transferee is determined in whole or in part by reference to the adjusted basis of that instrument in the hands of the transferor (i.e., the basis to the transferee is a carryover basis). However, the repeal of the except to the character of gain on retirement of debt instruments issued by natural person applies to any debt instruments issued after June 8, 1997.

Conference Agreement

The conference agreement generally follows the Senate amendment.

In addition, the conference agreement provides that if a taxpayer enters into a short sale of property and such property becomes substantially worthless, the taxpayer shall recognize gain as if the short sale were closed when the property becomes substantially worthless. The conference agreement also extends the statute of limitations with respect to such gain recognition to the earlier of: (1) three years after the Treasury Secretary is notified that the position has become substantially worthless; or (2) six years after the date of filing of the income tax return for the taxable year during which the position became substantially worthless. To the extent provided in Treasury regulations, similar gain recognition rules shall apply to any option with respect to property, any offsetting notional principal contract with respect to property, any futures or forward contract to deliver property, or with respect to any similar transaction or position that becomes substantially worthless. The provision applies to property that becomes substantially worthless after the date of enactment of the Act. No inference is intended as to the proper treatment of these or similar transactions or positions under present law.

6. Determination of original issue discount where pooled debt obligations subject to acceleration (sec. 1005 of the House bill)

Present Law

Inclusion of interest income, in general

A taxpayer generally must include in gross income the amount of interest received or accrued within the taxable year on indebtedness held by the taxpayer. If the principal amount of an indebtedness may be paid without interest by a specified date (as is the case with certain credit card balances), under present law, the holder of the indebtedness is not required to accrue interest until after the specified date has passed.

Original issue discount

The holder of a debt instrument with original issue discount ("OID") generally accrues and incudes in gross income, as interest, the OID over the life of the obligation, even though the amount of the interest may not be received until the maturity of the instrument.

Special rules for determining the amount of OID allocated to a period apply to certain instruments that may be subject to prepayment. First, if a borrower can reduce the yield on a debt by exercising a prepayment option, the OID rules assume that the borrower will prepay the debt. In addition, in the case of (1) any regular interest in a REMIC, (2) qualified mortgages held by a REMIC, or (3) any other debt instrument if payments under the instrument may be accelerated by reason of prepayments of other obligations securing the instrument, the daily portions of the OID on such debt instruments are determined by taking into account an assumption regarding the prepayment of principal for such instruments.

House Bill

The bill applies the special OID rule applicable to any regular interest in a REMIC, qualified mortgages held by a REMIC, or certain other debt instruments to any pool of debt instruments the yield on which may be reduced by reason of prepayments. Thus, under the bill, if a taxpayer holds a pool of credit card receivables that require interest to be paid if the borrowers do not pay their accounts by a specified date, the taxpayer would be required to accrue interest or OID on such pool based upon a reasonable assumption regarding the timing of the payments of the accounts in the pool. In addition, the Secretary of the Treasury is authorized to provide appropriate exemptions from the provision, including exemptions for taxpayers that hold a limited amount of debt instruments, such as small retailers.

Effective date.—The provision is effective for taxable years beginning after the date of enactment. If a taxpayer is required to change its method of accounting under the bill, such change would be treated as initiated by the taxpayer with the consent of the Secretary of the Treasury and any section 481 adjustment would be included in income ratably over a four-year period. It is understood that some taxpayers presently use a method of accounting similar to the method required to be used under the bill and have asked the Secretary of the Treasury for permission to change to a different method for pre-effective date years. So as not to require taxpayers to change methods of accounting multiple times, it is expected that the Secretary would not grant these pending requests.

Senate Amendment

No provision.

Conference Agreement

The conference agreement generally follows the House bill, with modifications. The conference agreement applies to any pool of debt instruments the yield on which may be affected by reason of prepayments. In addition, the conferees wish to clarify that it is within the discretion of the Secretary of the Treasury to grant changes of methods of accounting that are pending for pre-effective date years.

7. Deny interest deduction on certain debt instruments (sec. 1006 of the House bill)

Present Law

Whether an instrument qualifies for tax purposes as debt or equity is determined under all the facts and circumstances based on principles developed in case law. If an instrument qualifies as equity, the issuer generally does not receive a deduction for dividends paid and the holder generally includes such dividends in income (although corporate holders generally may obtain a dividends-received deduction of at least 70 percent of the amount of the dividend). If an instrument qualifies as debt, the issuer may receive a deduction for accrued interest and the holder generally includes interest in income, subject to certain limitations.

Original issue discount ("OID") on a debt instrument is the excess of the stated redemption price at maturity over the issue price of the instrument. An issuer of a debt instrument with OID generally accrues and deducts the discount as interest over the life of the instrument even though interest may not be paid until the instrument matures. The holder of such a debt instrument also generally includes the OID in income on an accrual basis.

House Bill

Under the House bill, no deduction is allowed for interest or OID on an instrument issued by a corporation (or issued by a partnership to the extent of its corporate partners) that is payable in stock of the issuer or a related party (within the meaning of sections 267(b) and 707(b)), including an instrument a substantial portion of which is mandatorily convertible or convertible at the issuer's option into stock of the issuer or a related party. In addition, an instrument is to be treated as payable in stock if a substantial portion of the principal or interest is required to be determined, or may be determined at the option of the issuer or related party, by reference to the value of stock of the issuer or related party. An instrument also is treated as payable in stock if it is part of an arrangement designed to result in such payment of the instrument with or by reference to such stock, such as in the case of certain issuances of a forward contract in connection with the issuance of debt, nonrecourse debt that is secured principally by such stock, or certain debt instruments that are convertible at the holder's option when it is substantially certain that the right will be exercised. For example, it is not expected that the provision will affect debt with a conversion feature where the conversion price is significantly higher than the market price of the stock on the issue date of the debt. The House bill does not affect the treatment of a holder of an instrument.

The House bill is not intended to affect the characterization of instruments as debt or equity under present law; and no inference is intended as to the treatment of any instrument under present law.

Effective date.—The provision is effective for instruments issued after June 8, 1997, but will not apply to such instruments (1) issued pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill. The conference agreement clarifies that for purposes of the provision, principal or interest shall be treated as required to be paid in, converted to, or determined with reference to the value of equity if it may be so required at the option of the holder or a related party and there is a substantial certainty that the option will be exercised.

B. Corporate Organizations and Reorganizations

1. Require gain recognition for certain extraordinary dividends (sec. 1011 of the House bill and sec. 811 of the Senate amendment)

Present Law

A corporate shareholder generally can deduct at least 70 percent of a dividend received from another corporation. This dividends received deduction is 80 percent if the corporate shareholder owns at least 20 percent of the distributing corporation and generally 100 percent if the shareholder owns at least 80 percent of the distributing corporation.

Section 1059 of the Code requires a corporate shareholder that receives an "extraordinary dividend" to reduce the basis of the stock with respect to which the dividend was received by the nontaxed portion of the dividend. Whether a dividend is "extraordinary" is determined, among other things, by reference to the size of the dividend in relation to the adjusted basis of the shareholder's stock. Also, a dividend resulting from a non pro rata redemption or a partial liquidation is an extraordinary dividend. If the reduction in basis of stock exceeds the basis in the stock with respect to which an extraordinary dividend is received, the excess is taxed as gain on the sale or disposition of such stock, but not until that time (sec. 1059(a)(2)). The reduction in basis for this purpose occurs immediately before any sale or disposition of the stock (sec. 1059(d)(1)(A)). The Treasury Department has general regulatory authority to carry out the purposes of the section.

Except as provided in regulations, the extraordinary dividend provisions do not apply to result in a double reduction in basis in the case of distributions between members of an affiliated group filing consolidated returns, where the dividend is eliminated or excluded under the consolidated return regulations. Double inclusion of earnings and profits (i.e., from both the dividend and from gain on the disposition of stock with a reduced basis) also should generally be prevented.[7] Treasury regulations provide for application of the provision when a corporation is a partner in a partnership that receives a distribution.[8]

In general, a distribution in redemption of stock is treated as a dividend, rather than as a sale of the stock, if it is essentially equivalent to a dividend (sec. 302). A redemption of the stock of a shareholder generally is essentially equivalent to a dividend if it does not result in a meaningful reduction in the shareholder's proportionate interest in the distributing corporation. Section 302(b) also contains several specific tests (e.g., a substantial reduction computation and a termination test) to identify redemptions that are not essentially equivalent to dividends. The determination whether a redemption is essentially equivalent to a dividend includes reference to the constructive ownership rules of section 318, including the option attribution rules of section 318(a)(4). The rules relating to treatment of cash or other property received in a reorganization contain a similar reference (sec. 356(a)(2)).

House Bill

Under the House bill, except as provided in regulations, a corporate shareholder recognizes gain immediately with respect to any redemption treated as a dividend (in whole or in part) when the nontaxed portion of the dividend exceeds the basis of the shares surrendered, if the redemption is treated as a dividend due to options being counted as stock ownership.[9]

In addition, the House bill requires immediate gain recognition whenever the basis of stock with respect to which any extraor-

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[7] See H. Rept. 99–841, II–166, 99th Cong. 2d Sess. (September 18, 1986).
[8] See Treas. reg. sec. 1.701–2(f), Example (2).
[9] Thus, for example, where a portion of such a distribution would not have been treated as a dividend due to insufficient earnings and profits, the rule applies to the portion treated as a dividend.

dinary dividend was received is reduced below zero. The reduction in basis of stock would be treated as occurring at the beginning of the ex-dividend date of the extraordinary dividend to which the reduction relates.

Reorganizations or other exchanges involving amounts that are treated as dividends under section 356 of the Code are treated as redemptions for purposes of applying the rules relating to redemptions under section 1059(e). For example, if a recapitalization or other transaction that involves a dividend under section 356 has the effect of a non pro rata redemption or is treated as a dividend due to options being counted as stock, the rules of section 1059 apply. Redemptions of shares, or other extraordinary dividends on shares, held by a partnership will be subject to section 1059 to the extent there are corporate partners (e.g., appropriate adjustments to the basis of the shares held by the partnership and to the basis of the corporate partner's partnership interest will be required).

Under continuing section 1059(g) of present law, the Treasury Department is authorized to issue regulations where necessary to carry out the purposes and prevent the avoidance of the provision.

Effective date.—The provision generally is effective for distributions after May 3, 1995, unless made pursuant to the terms of a written binding contract in effect on May 3, 1995 and at all times thereafter before such distribution, or a tender offer outstanding on May 3, 1995.[10] However, in applying the new gain recognition rules to any distribution that is not a partial liquidation, a non pro rata redemption, or a redemption that is treated as a dividend by reason of options, September 13, 1995 is substituted for May 3, 1995 in applying the transition rules.

No inference is intended regarding the tax treatment under present law of any transaction within the scope of the provision, including transactions utilizing options.

In addition, no inference is intended regarding the rules under present law (or in any case where the treatment is not specified in the provision) for determining the shares of stock with respect to which a dividend is received or that experience a basis reduction.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

[10] Thus, for example, in the case of a distribution prior to the effective date, the provisions of present law would continue to apply, including the provisions of present-law sections 1059(a) and 1059(d)(1), requiring reduction in basis immediately before any sale or disposition of the stock, and requiring recognition of gain at the time of such sale or disposition.

2. Require gain recognition on certain distributions of controlled corporation stock (sec. 1012 of the House bill and sec. 812 of the Senate amendment)

Present Law

A corporation generally is required to recognize gain on the distribution of property (including stock of a subsidiary) as if such property had been sold for its fair market value. The shareholders generally treat the receipt of property as a taxable event as well. Section 355 of the Internal Revenue Code provides an exception to this rule for certain "spin-off" type distributions of stock of a controlled corporation, provided that various requirements are met, including certain restrictions relating to acquisitions and dispositions of stock of the distributing corporation ("distributing") or the controlled corporation ("controlled") prior and subsequent to a distribution.

In cases where the form of the transaction involves a contribution of assets to the particular controlled corporation that is distributed in connection with the distribution, there are specific Code requirements that distributing corporation's shareholders own "control" of the distributed corporation immediately after the distribution. Control is defined for this purpose as 80 percent of the voting power of all classes of stock entitled to vote and 80 percent of each other class of stock. (secs. 368(a)(1)(D), 368(c), and 351(a) and (c)). In addition, it is a requirement for qualification of any section 355 distribution that the distributing corporation distribute control of the controlled corporation (defined by reference to the same 80-percent test).[11] Present law has the effect of imposing more restrictive requirements on certain types of acquisitions or other transfers following a distribution if the company involved is the controlled corporation rather than the distributing corporation.

After a spin-off transaction, the amount of a stockholder's basis in the stock of the distributing corporation is generally allocated between the stock of distributing and controlled received by that shareholder, in proportion to their relative fair market values. (sec. 358(c); see Treas. reg. sec. 1.358–2). In the case of an affiliated group of corporations filing a consolidated return, this basis allocation rule generally eliminates any excess loss account in the stock of a controlled corporation that is distributed within the group, and its basis is generally determined with reference to the basis of the distributing corporation.[12]

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[11] If a controlled corporation is acquired after a distribution, an issue may arise whether the acquisition can be viewed under step-transaction concepts as having occurred before the distribution, with the result that the distributing corporation would not be viewed as having distributed the necessary 80 percent control. The Internal Revenue Service has indicated that it will not rule on requests for section 355 treatment in cases in which there have been negotiations, agreements, or arrangements with respect to transactions or events which, if consummated before the distribution, would result in the distribution of stock or securities of a corporation which is not "controlled" by the distributing corporation. Rev. Proc. 96–39, 1996–33 I.R.B. 11; see also Rev. Rul. 96–30, 1996–1 C.B. 36; Rev. Rul. 70–225, 1970–1 C.B. 80.

[12] Excess loss accounts in consolidation generally are created when a subsidiary corporation makes a distribution (or has a loss that is used by other members of the group) that exceeds the parent's basis in the stock of the subsidiary. In general, such excess loss accounts in consolidation are permitted to be deferred rather than causing immediate taxable gain. Nevertheless, they are recaptured when a subsidiary leaves the group or in certain other situations. However, such excess loss accounts are not recaptured in certain cases where there is an internal spin-

Continued

The treatment of basis of the distributing and controlled corporations in a section 355 distribution differs from a distribution of stock that is not a qualified section 355 spin-off. In a non-qualified distribution within an affiliated group of corporations filing a consolidated return, not only is gain generally recognized (though deferred) on the excess of value over basis at the distributing corporation level, the basis of the distributing corporation's stock is increased by any gain recognized in the distribution (when that gain is taken into account under the relevant regulations), and reduced by the fair market value of the distribution if the distribution is within an affiliated group filing a consolidated return. The basis of the stock of the distributed corporation within the group is a fair market value basis. In the case of a distribution between members of an affiliated group that is not filing a consolidated return, the distribution causes a reduction of basis of the distributing corporation only to the extent it exceeds the earnings and profits of the distributing corporation or it is an extraordinary dividend.

House Bill

The House bill adopts additional restrictions under section 355 on acquisitions and dispositions of the stock of the distributing or controlled corporation.

Under the House bill, if, pursuant to a plan or arrangement in existence on the date of distribution, either the controlled or distributing corporation is acquired, gain is recognized by the other corporation as of the date of the distribution.

In the case of an acquisition of a controlled corporation, the amount of gain recognized by the distributing corporation is the amount of gain that the distributing corporation would have recognized had stock of the controlled corporation been sold for fair market value on the date of distribution. In the case of an acquisition of the distributing corporation, the amount of gain recognized by the controlled corporation is the amount of net gain that the distributing corporation would have recognized had it sold its assets for fair market value immediately after the distribution. This gain is treated as long-term capital gain. No adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.

Whether a corporation is acquired is determined under rules similar to those of present law section 355(d), except that acquisitions would not be restricted to "purchase" transactions. Thus, an acquisition occurs if one or more persons acquire 50 percent or more of the vote or value of the stock of the controlled or distributing corporation pursuant to a plan or arrangement. For example, assume a corporation ("P") distributes the stock of its wholly owned subsidiary ("S") to its shareholders. If, pursuant to a plan or arrangement, 50 percent or more of the vote or value of either P or S is acquired by one or more persons, the bill proposal requires gain recognition by the corporation not acquired. Except as provided in Treasury regulations, if the assets of the distributing or

off prior to the subsidiary leaving the group. See, Treas. reg. sec. 1.1502–19(g). In addition, an excess loss account may not be created at all in certain cases that are similar economically to a distribution that would reduce the stock basis of the distributing subsidiary corporation, if the distribution from the subsidiary is structured to meet the form of a section 355 distribution.

controlled corporation are acquired by a successor in a merger or other transaction under section 368(a)(1)(A), (C) or (D) of the Code, the shareholders (immediately before the acquisition) of the corporation acquiring such assets are treated as acquiring stock in the corporation from which the assets were acquired. Under Treasury regulations, other asset transfers also could be subject to this rule. However, in any transaction, stock received directly or indirectly by former shareholders of distributing or controlled, in a successor or new controlling corporation of either, is not to be treated as acquired stock if it is attributable to such shareholders' stock in distributing or controlled that was not acquired as part of a plan or arrangement to acquire 50 percent or more of such successor or other corporation.

Acquisitions occurring within the four-year period beginning two years before the date of distribution are presumed to have occurred pursuant to a plan or arrangement. Taxpayers can avoid gaining recognition by showing that an acquisition occurring during this four-year period was unrelated to the distribution.

The House bill does not apply to distributions that would otherwise be subject to section 355(d) of present law, which imposes corporate level tax on certain disqualified distributions.

The House bill does not apply to a distribution pursuant to a title 11 or similar case.

The Treasury Department is authorized to prescribe regulations as necessary to carry out the purposes of the proposal, including regulations to provide for the application of the proposal in the case of multiple transactions.

Except as provided in regulations, in the case of distributions of stock within an affiliated group of corporations filing a consolidated return, section 355 does not apply to any distribution of the stock of one member of the group to another member. In the case of such a distribution of stock, the Secretary of the Treasury is to provide appropriate rules for the treatment of the distribution, including rules governing adjustments to the adjusted basis of the stock and the earnings and profits of the members of the group.

The House bill also modifies certain rules for determining control immediately after a distribution in the case of certain divisive transactions in which a controlled corporation is distributed and the transaction meets the requirements of section 355. In such cases, under section 351 and modified section 368(a)(2)(H) with respect to certain reorganizations under section 368(a)(1)(D), those shareholders receiving stock in the distributed corporation are treated as in control of the distributed corporation immediately after the distribution if they hold stock representing a 50 percent or greater interest in the vote and value of stock of the distributed corporation.

The House bill does not change the present-law requirement under section 355 that the distributing corporation must distribute 80 percent of the voting power and 80 percent of each other class of stock of the controlled corporation. It is expected that this requirement will be applied by the Internal Revenue Service taking account of the provisions of the proposal regarding plans that permit certain types of planned restructuring of the distributing corporation following the distribution, and to treat similar restructurings of the controlled corporation in a similar manner. Thus, the 80-percent control requirement is expected to be administered in a manner that would prevent the tax-free spin-off of a less-than-80-percent controlled subsidiary, but would not generally impose additional restrictions on post-distribution restructurings of the controlled corporation if such restrictions would not apply to the distributing corporation.

Effective date.—The provision is generally effective for distributions after April 16, 1997. However, the part of the provision that provides a 50-percent control requirement immediately after certain section 351 and 368(a)(1)(D) distributions governed by section 355 is effective for transfers after the date of enactment.

No part of the provision will apply to a distribution (or transfer, as the case may be) after April 16, 1997, if such distribution or transfer is: (1) made pursuant to a written agreement which was binding on such date and at all times thereafter; (2) described in a ruling request submitted to the Internal Revenue Service on or before such date; or (3) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission ("SEC") required solely by reason of the distribution. Any written agreement, ruling request, or public announcement is not within the scope of these transition provisions unless it identifies the unrelated acquiror of the distributing corporation or of any controlled corporation, whichever is applicable.

Senate Amendment

The Senate amendment generally follows the House bill with a number of modifications.

The Senate amendment modifies the House bill denial of section 355 treatment to certain distributions within an affiliated group of corporations. Under the Senate amendment, except as provided in Treasury regulations, in the case of distributions of stock within an affiliated group of corporations (as defined in section 1504(a), and whether or not filing a consolidated return), section 355 does not apply to any distribution of the stock of one member of the group to another member if the distribution is part of a transaction that results in an acquisition that would be taxable to either the distributing or the controlled corporation under the provision.

In addition, in the case of any distribution of stock of one member of an affiliated group of corporations to another member, the Secretary of the Treasury is authorized under section 358(c) to provide adjustments to the basis of any stock in a corporation which is a member of such group, to reflect appropriately the proper treatment of such distribution. As one example, the Secretary of the Treasury may consider providing rules that require a carryover basis within the group for the stock of the distributed corporation (including a carryover of an excess loss account, if any, in a consolidated return) and that also provide a reduction in the basis of the stock of the distributing corporation to reflect the change in the value and basis of the distributing corporation's assets. The Treasury Department may determine that the aggregate stock basis of distributing and controlled after the distribution may be adjusted to an amount that is less than the aggregate basis of the stock of the distributing corporation before the distribution, to prevent inappropriate potential for artificial losses or diminishment of gain on disposition of any of the corporations involved in the spin off.

The Senate amendment modifies the House bill rules for determining control immediately after a distribution in the case of certain divisive transactions in which a controlled corporation is distributed and the transaction meets the requirements of section 355. In such cases, under section 351 and modified section 368(a)(2)(H) with respect to certain reorganizations under section 368(a)(1)(D), those shareholders receiving stock in the distributed corporation are treated as in control of the distributed corporation immediately after the distribution if they hold stock representing a greater than 50 percent interest (rather than a 50 percent or greater interest, as under the House bill) in the vote and value of stock of the distributed corporation.

Effective date.—The provision is generally effective for distributions after April 16, 1997. However, the part of the amendment providing a greater-than-50-percent control requirement immediately after certain section 351 and 368(a)(1)(D) distributions governed by section 355 is effective for transfers after the date of enactment.

The provision will not apply to a distribution after April 16, 1997 that is part of an acquisition that would otherwise cause gain recognition to the distributing or controlled corporation under the bill, if such acquisition is: (1) made pursuant to a written agreement which was binding on April 16, 1997 and at all times thereafter; (2) described in a ruling request submitted to the Internal Revenue Service on or before such date; or (3) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission ("SEC") required solely by reason of the distribution or acquisition. Any written agreement, ruling request, or public announcement or SEC filing is not within the scope of these transition provisions unless it identifies the acquiror of the distributing corporation or of any controlled corporation, whichever is applicable.

The part of the provision that provides a greater-than-50-percent control provision for certain transfers after the date of enactment will not apply if such transfer meets the requirements of (1), (2), or (3) of the preceding paragraph.

Conference Agreement

The conference agreement follows the Senate amendment with additional modifications.

Amount and timing of gain recognition under section 355(e)

Under the conference agreement, in the case of an acquisition of either the distributing corporation or the controlled corporation, the amount of gain recognized is the amount that the distributing corporation would have recognized had the stock of the controlled corporation been sold for fair market value on the date of the distribution. Such gain is recognized immediately before the distribution. As under the House bill and Senate amendment, no adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.[13]

Acquisitions resulting in gain recognition

Under the conference agreement, as under the House bill and Senate amendment, the gain recognition provisions of section 355(e) apply when one or more persons acquire 50 percent or more of the voting power or value of the stock of either the distributing corporation or the controlled corporation, pursuant to a plan or series of related transactions.

The conference agreement provides certain additions and clarifications to identify cases that do not cause gain recognition under the provisions of section 355(e).

Single affiliated group

Under the conference agreement, a plan (or series of related transactions) is not one that will cause gain recognition if, immediately after the completion of such plan or transactions, the distributing corporation and all controlled corporations are members of a single affiliated group of corporations (as defined in section 1504 without regard to subsection (b) thereof).

Example 1: P corporation is a member of an affiliated group of corporations that includes subsidiary corporation S and subsidiary corporation S1. P owns all the stock of S. S owns all the stock of S1. P corporation is merged into unrelated X corporation in a transaction in which the former shareholders of X corporation will own 50 percent or more of the vote or value of the stock of surviving X corporation after the merger. As part of the plan of merger, S1 will be distributed by S to X, in a transaction that otherwise qualifies under section 355. After this distribution, S, S1, and X will remain members of a single affiliated group of corporations under section 1504 (without regard to whether any of the corporations is a foreign corporation, an insurance company, a tax exempt organization, or an electing section 936 company). Even though there has been an acquisition of P, S, and S1 by X, and a distribution of S1 by S that is part of a plan or series of related transactions, the plan is not treated as one that requires gain recognition on the distribution of S1 to X. This is because the distributing corporation S and the controlled corporation S1 remain within a single affiliated group after the distribution (even though the P group has changed ownership).

Continuing direct or indirect ownership

The conference agreement clarifies that an acquisition does not require gain recognition if the same persons own 50 percent or more of both corporations, directly or indirectly (rather than merely indirectly, as in the House bill and Senate amendment), before and after the acquisition and distribution, provided the stock owned before the acquisition was not acquired as part of a plan (or series

[13] There is no intention to limit the otherwise applicable Treasury regulatory authority under section 336(e) of the Code. There is also no intention to limit the otherwise applicable provisions of section 1367 with respect to the effect on shareholder stock basis of gain recognized by an S corporation under this provision.

of related transactions) to acquire a 50 percent or greater interest in either distributing or controlled.

Example 2: Individual A owns all the stock of P corporation. P owns all the stock of a subsidiary corporation, S. Subsidiary S is distributed to individual A in a transaction that otherwise qualifies under section 355. As part of a plan, P then merges with corporation X, also owned entirely by individual A. There is not an acquisition that requires gain recognition under the provision, because individual A owns directly or indirectly 100 percent of all the stock of both X, the successor to P, and S before and after the transaction.[14] The same result would occur if P were contributed to a holding company, all the stock of which is owned by A.

The conference agreement, following the House bill and Senate amendment, continues to provide that except as provided in Treasury regulations, certain other acquisitions are not taken into account. For example, under section 355(e)(3)(A), the following other types of acquisitions of stock are not subject to the provision, provided that the stock owned before the acquisition was not acquired pursuant to a plan or series of related transactions to acquire a 50-percent or greater ownership interest in either distributing or controlled:

First, the acquisition of stock in the controlled corporation by the distributing corporation (as one example, in the case of a drop-down of property by the distributing corporation to the corporation to be distributed in exchange for the stock of the controlled corporation);

Second, the acquisition by a person of stock in any controlled corporation by reason of holding stock or securities in the distributing corporation (as one example, the receipt by a distributing corporation shareholder of controlled corporation stock in a distribution—including a split-off distribution in which a shareholder that did not own 50 percent of the stock of distributing owns 50 percent or more of the stock of controlled); and

Third, the acquisition by a person of stock in any successor corporation of the distributing corporation or any controlled corporation by reason of holding stock or securities in such distributing or controlled corporation (for example, the receipt by former shareholders of distributing of 50 percent or more of the stock of a successor corporation in a merger of distributing).

As under the House bill and Senate amendment, a public offering of sufficient size can result in an acquisition that causes gain recognition under the provision.

Attribution

The conference agreement also modifies the attribution rule for determining when an acquisition has occurred. Rather than apply section 355(d)(8)(A), which attributes stock owned by a corporation to a corporate shareholder only if that shareholder owns 10 percent of the corporation, the conference agreement provides that, except

[14] The example assumes that A did not acquire his or her stock in P as part of a plan or series of related transactions that results in the direct or indirect ownership of 50 percent or more of S or P separately by A. If A's stock in P was acquired as part of such a plan, the transaction would be one requiring gain recognition on the spin-off of S.

as provided in regulations, section 318(a)(2)(C) applies without regard to the amount of stock ownership of the corporation.

Example 3: Assume the facts are the same as in the immediately preceding example except that corporations P and X are each owned by the same 20 individual 5-percent shareholders (rather than wholly by individual A). The transaction described in the previous example, in which S is spun off by P to P's shareholders and P is acquired by X, would not cause gain recognition, because the same shareholders would own directly or indirectly 50 percent or more of the stock of each corporation both before and after the transaction.

Section 355(f)

The conference agreement follows the Senate amendment in providing that, except as provided in Treasury regulations, section 355 (or so much of section 356 as relates to section 355) shall not apply to the distribution of stock from one member of an affiliated group of corporations (as defined in section 1504(a)) to another member of such group (an "intragroup spin-off") if such distribution is part of a plan (or series of related transactions) described in subsection (e)(2)(A)(ii), pursuant to which one or more persons acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or any controlled corporation.

Example 4: P corporation owns all the stock of subsidiary corporation S. S owns all the stock of subsidiary corporation T. S distributes the stock of T corporation to P as part of a plan or series of related transactions in which P then distributes S to its shareholders and then P is merged into unrelated X corporation. After the merger, former shareholders of X corporation own 50 percent or more of the voting power or value of the stock of the merged corporation. Because the distribution of T by S is part of a plan or series of related transactions in which S is distributed by P outside the P affiliated group and P is then acquired under section 355(e), section 355 in its entirety does not apply to the intragroup spin-off of T to P, under section 355(f). Also, the distribution of S by P is subject to section 355(e).

The conference agreement clarifies that, in determining whether an acquisition described in subsection (e)(2)(A)(ii) occurs, all the provisions of new subsection 355(e) are applied. For example, an intragroup spin-off in connection with an overall transaction that does not cause gain recognition under section 355(e) because it is described in section 355(e)(2)(C), or because of section 355(e)(3), is not subject to the rule of section 355(f).

The Treasury Department has regulatory authority to vary the result that the intragroup distribution under section 355(f) does not qualify for section 355 treatment. In this connection, the Treasury Department could by regulation eliminate some or all of the gain recognition required under section 355(f) in connection with the issuance of regulations that would cause appropriate basis results with respect to the stock of S and T in the above example so that concerns regarding present law section 355 basis rules (described below in connection with section 358(c)) would be eliminated.[15]

Treasury regulatory authority under section 358(c)

As under the Senate amendment, the conference agreement provides that in the case of any distribution of stock of one member of an affiliated group of corporations to another member under section 355 ("intragroup spin-off"), the Secretary of the Treasury is authorized under section 358(c) to provide adjustments to the basis of any stock in a corporation which is a member of such group, to reflect appropriately the proper treatment of such distribution. It is understood that the approach of any such regulations applied to intragroup spin-offs that do not involve an acquisition may also be applied under the Treasury regulatory authority to modify the rule of section 355(f) as may be appropriate.

The conferees believe that the concerns relating to basis adjustments in the case of intragroup spin offs are essentially similar, whether or not an acquisition is currently intended as part of a plan or series of related transactions. The concerns include the following. First, under present law consolidated return regulations, it is possible that an excess loss account of a lower tier subsidiary may be eliminated. This creates the potential for the subsidiary to leave the group without recapture of the excess loss account, even though the group has benefitted from the losses or distributions in excess of basis that led to the existence of the excess loss account.

Second, under present law, a shareholder's stock basis in its stock of the distributing corporation is allocated after a spin-off between the stock of the distributing and controlled corporations, in proportion to the relative fair market values of the stock of those companies. If a disproportionate amount of asset basis (as compared to value) is in one of the companies (including but not limited to a shift of value and basis through a borrowing by one company and contribution of the borrowed cash to the other), present law rules under section 358(c) can produce an increase in stock basis relative to asset basis in one corporation, and a corresponding decrease in stock basis relative to asset basis in the other company. Because the spin-off has occurred within the corporate group, the group can continue to benefit from high inside asset basis either for purposes of sale or depreciation, while also choosing to benefit from the disproportionately high stock basis in the other corporation. If, for example, both corporations were sold at a later date, a prior distribution can result in a significant decrease in the amount of gain recognized than would have occurred if the two corporations had been sold together without a prior spin off (or separately, without a prior spin-off).

Example 5: P owns all the stock of S1 and S1 owns all the stock of S2. P's basis in the stock of S1 is 50; the inside asset basis of S1's assets is 50; and the total value of S1's stock and assets (including the value of S2) is 150. S1's basis in the stock of S2 is 0; the inside basis of S2's assets is 0; and the value of S2's stock and assets is 100. If S1 were sold, holding S2, the total gain would be

[15] Examples of approaches that the Treasury Department may consider are discussed in connection with section 358(c), *infra*.)

100. S1 distributes S2 to P in a section 355 transaction. After this spin-off, under present law, P's basis in the stock of S1 is approximately 17 (50/150 times the total 50 stock basis in S1 prior to the spin-off) and the inside asset basis of S1 is 50. P's basis in the stock of S2 is 33 (100/150 times the total 50 stock basis in S1 prior to the spin-off) and the inside asset basis of S2 is 0. After a period of time, S2 can be sold for its value of 100, with a gain of 67 rather than 100. Also, since S1 remains in the corporate group, the full 50 inside asset basis can continue to be used. S1's assets could be sold for 50 with no gain or loss. Thus, S1 and S2 can be sold later at a total gain of 67, rather than the total gain of 100 that would have occurred had they been sold without the spin-off.

As one variation on the foregoing concern, taxpayers have attempted to utilize spin-offs to extract significant amounts of asset value and basis, (including but not limited to transactions in which one corporation decreases its value by incurring debt, and increases the asset basis and value of the other corporation by contributing the proceeds of the debt to the other corporation) without creation of an excess loss account or triggering of gain, even when the extraction is in excess of the basis in the distributing corporation's stock.

The Treasury Department may promulgate any regulations necessary to address these concerns and other collateral issues. As one example, the Treasury Department may consider providing rules that require a carryover basis within the group (or stock basis conforming to asset basis as appropriate) for the distributed corporation (including a carryover of an excess loss account, if any, in a consolidated return). Similarly, the Treasury Department may provide a reduction in the basis of the stock of the distributing corporation to reflect the change in the value and basis of the distributing corporation's assets. The Treasury Department may determine that the aggregate stock basis of distributing and controlled after the distribution may be adjusted to an amount that is less than the aggregate basis of the stock of the distributing corporation before the distribution, to prevent inappropriate potential for artificial losses or diminishment of gain on disposition of any of the corporations involved in the spin-off. The Treasury Department may provide separate regulations for corporations in affiliated groups filing a consolidated return and for affiliated groups not filing a consolidated return, as appropriate to each situation.

Effective date

The conferees wish to clarify certain aspects of the effective date and transitional relief under the provision.

First, the conference agreement clarifies that an acquisition of stock that occurs on or before April 16, 1997 will not cause gain recognition under the provision, even if there is a distribution after that date that is part of a plan or series of related transactions that would otherwise be subject to the provision.

Second, any contract that is in fact binding under State law as of April 16, 1997, even though not written, is eligible for transition relief. It would be expected, in such a case, that some form of contemporaneous written evidence of such contract would be in existence. As one example, if under State law acceptance of the terms and conditions of a contract by a corporate board of directors creates a binding contract with an acquiror, then such contract, and the terms and conditions presented to the board, could satisfy the requirement for binding contract transitional relief under the conference agreement. If there was such an offer and acceptance on or before April 16, 1997 and a ruling request filed on or before April 16, 1997, with respect to a proposed spin-off and acquisition, which identifies the acquiror as one of a list of prospective acquirors, then the transaction may be eligible for relief under the transition rules.

Finally, with respect to the Treasury Department regulatory authority under section 358(c) as applied to intragroup spin-off transactions that are not part of a plan or series of related transactions under new section 355(f), the conferees expect that any Treasury regulations will be applied prospectively, except in cases to prevent abuse.

3. Reform tax treatment of certain corporate stock transfers (sec. 1013 of the House bill and sec. 813 of the Senate amendment)

Present Law

Under section 304, if one corporation purchases stock of a related corporation, the transaction generally is recharacterized as a redemption. In determining whether a transaction so recharacterized is treated as a sale or a dividend, reference is made to the changes in the selling corporation's ownership of stock in the issuing corporation (applying the constructive ownership rules of section 318(a) with modifications under section 304(c)). Sales proceeds received by a corporate transferor that are characterized as a dividend may qualify for the dividends received deduction under section 243, and such dividend may bring with it foreign tax credits under section 902. Section 304 does not apply to transfers of stock between members of a consolidated group.

Section 1059 applies to "extraordinary dividends," including certain redemption transactions treated as dividends qualifying for the dividends received deduction. If a redemption results in an extraordinary dividend, section 1059 generally requires the shareholder to reduce its basis in the stock of the redeeming corporation by the nontaxed portion of such dividend.

House Bill

Under the House bill, to the extent that a section 304 transaction is treated as a distribution under section 301, the transferor and the acquiring corporation are treated as if (1) the transferor had transferred the stock involved in the transaction to the acquiring corporation in exchange for stock of the acquiring corporation in a transaction to which section 351(a) applies, and (2) the acquiring corporation had then redeemed the stock it is treated as having issued. Thus, the acquiring corporation is treated for all purposes as having redeemed the stock it is treated as having issued to the transferor. In addition, the bill amends section 1059 so that, if the section 304 transaction is treated as a dividend to which the dividends received deduction applies, the dividend is treated as an extraordinary dividend in which only the basis of the transferred shares would be taken into account under section 1059.

Under the House bill, a special rule applies to section 304 transactions involving acquisitions by foreign corporations. The bill limits the earnings and profits of the acquiring foreign corporation that are taken into account in applying section 304. The earnings and profits of the acquiring foreign corporation to be taken into account will not exceed the portion of such earnings and profits that (1) is attributable to stock of such acquiring corporation held by a corporation or individual who is the transferor (or a person related thereto) and who is a U.S. shareholder (within the meaning of sec, 951(b)) of such corporation, and (2) was accumulated during periods in which such stock was owned by such person while such acquiring corporation was a controlled foreign corporation. For purposes of this rule, except as otherwise provided by the Secretary of the Treasury, the rules of section 1248(d) (relating to certain exclusions from earnings and profits) would apply. The Secretary of the Treasury is to prescribe regulations as appropriate, including regulations determining the earnings and profits that are attributable to particular stock of the acquiring corporation.

No inference is intended as to the treatment of any transaction under present law.

Effective date.—The provision is effective for distributions or acquisitions after June 8, 1997 except that the provision will not apply to any such distribution or acquisition (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House Bill and the Senate amendment.

4. Modify holding period for dividends-received deduction (sec. 1014 of the House bill and sec. 814 of the Senate amendment)

Present Law

If an instrument issued by a U.S. corporation is classified for tax purposes as stock, a corporate holder of the instrument generally is entitled to a dividends received deduction for dividends received on that instrument. This deduction is 70 percent of dividends received if the recipient owns less than 20 percent (by vote and value) of stock of the payor. If the recipient owns more than 20 percent of the stock the deduction is increased to 80 percent. If the recipient owns more than 80 percent of the payor's stock, the deduction is further increased to 100 percent for qualifying dividends.

The dividends-received deduction is allowed to a corporate shareholder only if the shareholder satisfies a 46-day holding period for the dividend-paying stock (or a 91-day period for certain dividends on preferred stock). The 46- or 91-day holding period generally does not include any time in which the shareholder is protected from the risk of loss otherwise inherent in the ownership of an equity interest. The holding period must be satisfied only once, rather than with respect to each dividend received.

House Bill

The House bill provides that a taxpayer is not entitled to a dividends-received deduction if the taxpayer's holding period for the dividend-paying stock is not satisfied over a period immediately before or immediately after the taxpayer becomes entitled to receive the dividend.

Effective date.—The provision is effective for dividends paid or accrued after the 30th day after the date of the enactment.

Senate Amendment

The Senate amendment is the same as the House bill except for the effective date.

Effective date.— The Senate amendment is generally effective for dividends paid or accrued after the 30th day after the date of enactment. However, the provision will not apply to dividends received within two years of the date of enactment if: (1) the dividend is paid with respect to stock held on June 8, 1997, and all times thereafter until the dividend is received; (2) the stock is continuously subject to a position described in section 246(c)(4) on June 8, 1997, and all times thereafter until the dividend is received; and (3) such stock and related position is identified by the taxpayer within 30 days after enactment of this Act. A stock will not be considered to be continuously subject to a position if such position is sold, closed or otherwise terminated and is reestablished.

Conference Agreement

The conference agreement follows the Senate amendment.

C. Other Corporate Provisions

1. Registration of confidential corporate tax shelters and substantial understatement penalty (sec. 1021 of the House bill and sec. 821 of the Senate amendment)

Present Law

Tax shelter registration

An organizer of a tax shelter is required to register the shelter with the Internal Revenue Service (IRS) (sec. 6111). If the principal organizer does not do so, the duty may fall upon any other participant in the organization of the shelter or any person participating in its sale or management. The shelter's identification number must be furnished to each investor who purchases or acquires an interest in the shelter. Failure to furnish this number to the tax shelter investors will subject the organizer to a $100 penalty for each such failure (sec. 6707(b)).

A penalty may be imposed against an organizer who fails without reasonable cause to timely register the shelter or who provides false or incomplete information with respect to it. The penalty is the greater of one percent of the aggregate amount invested in the shelter or $500. Any person claiming any tax benefit with respect to a shelter must report its registration number on her return. Failure to do so without reasonable cause will subject that person to a $250 penalty (sec. 6707(b)(2)).

A person who organizes or sells an interest in a tax shelter subject to the registration rule or in any other potentially abusive plan or arrangement must maintain a list of the investors (sec. 6112). A $50 penalty may be assessed for each name omitted from the list. The maximum penalty per year is $100,000 (sec. 6708).

For this purpose, a tax shelter is defined as any investment that meets two requirements. First, the investment must be (1) required to be registered under a Federal or state law regulating securities, (2) sold pursuant to an exemption from registration requiring the filing of a notice with a Federal or state agency regulating the offering or sale of securities, or (3) a substantial investment. Second, it must be reasonable to infer that the ratio of deductions and 350 percent of credits to investment for any investor (i.e., the tax shelter ratio) may be greater than two to one as of the close of any of the first five years ending after the date on which the investment is offered for sale. An investment that meets these requirements will be considered a tax shelter regardless of whether it is marketed or customarily designated as a tax shelter (sec. 6111(c)(1)).

Accuracy-related penalty

The accuracy-related penalty, which is imposed at a rate of 20 percent, applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation misstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement.

The substantial understatement penalty applies in the following manner. If the correct income tax liability of a taxpayer for a taxable year exceeds that reported by the taxpayer by the greater of 10 percent of the correct tax or $5,000 ($10,000 in the case of most corporations), then a substantial understatement exists and a penalty may be imposed equal to 20 percent of the underpayment of tax attributable to the understatement. In determining whether a substantial understatement exists, the amount of the understatement is reduced by any portion attributable to an item if (1) the treatment of the item on the return is or was supported by substantial authority, or (2) facts relevant to the tax treatment of the item were adequately disclosed on the return or on a statement attached to the return and there was a reasonable basis for the tax treatment of the item. Special rules apply to tax shelters.

With respect to tax shelter items of non-corporate taxpayers, the penalty may be avoided only if the taxpayer establishes that, in addition to having substantial authority for his position, he reasonably believed that the treatment claimed was more likely than not the proper treatment of the item. This reduction in the penalty is unavailable to corporate tax shelters. The reduction in the understatement for items disclosed on the return is inapplicable to both corporate and non-corporate tax shelters. For this purpose, a tax shelter is a partnership or other entity, plan, or arrangement the principal purpose of which is the avoidance or evasion of Federal income tax.

The Secretary may waive the penalty with respect to any item if the taxpayer establishes reasonable cause for his treatment of the item and that he acted in good faith.

House Bill

Tax shelter registration

The House bill requires a promoter of a corporate tax shelter to register the shelter with the Secretary. Registration is required not later than the next business day after the day when the tax shelter is first offered to potential users. If the promoter is not a U.S. person, or if a required registration is not otherwise made, then any U.S. participant is required to register the shelter. An exception to this special rule provides that registration would not be required if the U.S. participant notifies the promoter in writing not later than 90 days after discussions began that the U.S. participant will not participate in the shelter and the U.S. person does not in fact participate in the shelter.

A corporate tax shelter is any investment, plan, arrangement or transaction (1) a significant purpose of the structure of which is tax avoidance or evasion by a corporate participant, (2) that is offered to any potential participant under conditions of confidentiality, and (3) for which the tax shelter promoters may receive total fees in excess of $100,000.

A transaction is offered under conditions of confidentiality if: (1) an offeree (or any person acting on its behalf) has an understanding or agreement with or for the benefit of any promoter to restrict or limit its disclosure of the transaction or any significant tax features of the transaction; or (2) the promoter claims, knows or has reason to know (or the promoter causes another person to claim or otherwise knows or has reason to know that a party other than the potential offeree claims) that the transaction (or one or more aspects of its structure) is proprietary to the promoter or any party other than the offeree, or is otherwise protected from disclosure or use. The promoter includes specified related parties.

Registration will require the submission of information identifying and describing the tax shelter and the tax benefits of the tax shelter, as well as such other information as the Treasury Department may require.

Tax shelter promoters are required to maintain lists of those who have signed confidentiality agreements, or otherwise have been subjected to nondisclosure requirements, with respect to particular tax shelters. In addition, promoters must retain lists of those paying fees with respect to plans or arrangements that have previously been registered (even though the particular party may not have been subject to confidentiality restrictions).

All registrations will be treated as taxpayer information under the provisions of section 6103 and will therefore not be subject to any public disclosure.

The penalty for failing to timely register a corporate tax shelter is the greater of $10,000 or 50 percent of the fees payable to any promoter with respect to offerings prior to the date of late registration (i.e., this part of the penalty does not apply to fee payments with respect to offerings after late registration). A similar penalty is applicable to actual participants in any corporate tax shelter who were required to register the tax shelter but did not. With respect to participants, however, the 50-percent penalty is based only on fees paid by that participant. Intentional disregard of the requirement to register by either a promoter or a participant increases the 50-percent penalty to 75 percent of the applicable fees.

Substantial understatement penalty

The House bill makes two modifications to the substantial understatement penalty. The first modification affects the reduction in the amount of the understatement which is attributable to an item if there is a reasonable basis for the treatment of the item. The House bill provides that in no event would a corporation have a reasonable basis for its tax treatment of an item attributable to a multi-party financing transaction if such treatment does not clearly reflect the income of the corporation. No inference is intended that such a multi-party financing transaction could not also be a tax shelter as defined under the modification described below or under present law.

The second modification affects the special tax shelter rules, which define a tax shelter as an entity the principal purpose of which is the avoidance or evasion of Federal income tax. The House bill instead provides that a significant purpose (rather than the principal purpose) of the entity must be the avoidance or evasion of Federal income tax for the entity to be considered a tax shelter. This modification conforms the definition of tax shelter for purposes of the substantial understatement penalty to the definition of tax shelter for purposes of these new confidential corporate tax shelter registration requirements.

Treasury report

The House bill also directs the Treasury Department, in consultation with the Department of Justice, to issue a report to the tax-writing committees on the following tax shelter issues: (1) a description of enforcement efforts under section 7408 of the Code (relating to actions to enjoin promoters of abusive tax shelters) with respect to corporate tax shelters and the lawyers, accountants, and others who provide opinions (whether or not directly addressed to the taxpayer) regarding aspects of corporate tax shelters; (2) an evaluation of whether the penalties regarding corporate tax shelters are generally sufficient; and (3) an evaluation of whether confidential tax shelter registration should be extended to transactions where the investor (or potential investor) is not a corporation. The report is due one year after the date of enactment.

Effective date

The tax shelter registration provision applies to any tax shelter offered to potential participants after the date the Treasury Department issues guidance with respect to the filing requirements. The modifications to the substantial understatement penalty apply to items with respect to transactions entered into after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Treat certain preferred stock as "boot" (sec. 1022 of the House bill and sec. 822 of the Senate amendment)

Present Law

In reorganization transactions within the meaning of section 368 and certain other restructurings, no gain or loss is recognized except to the extent "other property" (often called "boot") is received, that is, property other than certain stock, including preferred stock. Thus, preferred stock can be received tax-free in a reorganization. Upon the receipt of "other property," gain but not loss can be recognized. A special rule permits debt securities to be received tax-free, but only to the extent debt securities of no lesser principal amount are surrendered in the exchange. Other than this debt-for-debt rule, similar rules generally apply to transactions under section 351.

House Bill

The House bill amends the relevant provisions (secs. 351, 354, 355, 356 and 1036) to treat certain preferred stock as "other property" (i.e., "boot") subject to certain exceptions. Thus, when a taxpayer exchanges property for this preferred stock in a transaction that qualifies under either section 351, 355, 368, or 1036, gain but not loss is recognized.

The House bill applies to preferred stock (i.e., stock that is limited and preferred as to dividends and does not participate, including through a conversion privilege, in corporate growth to any significant extent), where (1) the holder has the right to require the issuer or a related person (within the meaning of secs. 267(b) and 707(b)) to redeem or purchase the stock, (2) the issuer or a related person is required to redeem or purchase the stock, (3) the issuer (or a related person) has the right to redeem or purchase the stock and, as of the issue date, it is more likely than not that such right will be exercised, or (4) the dividend rate on the stock varies in whole or in part (directly or indirectly) with reference to interest rates, commodity prices, or other similar indices, regardless of whether such varying rate is provided as an express term of the stock (for example, in the case of an adjustable rate stock) or as a practical result of other aspects of the stock (for example, in the case of auction rate stock). For this purpose, the rules of (1), (2), and (3) apply if the right or obligation may be exercised within 20 years of the date the instrument is issued and such right or obligation is not subject to a contingency which, as of the issue date, makes remote the likelihood of the redemption or purchase. In addition, if neither the stock surrendered nor the stock received in the exchange is stock of a corporation any class of stock of which (or of a related corporation) is publicly traded, a right or obligation is disregarded if it may be exercised only upon the death, disability, or mental incompetency of the holder. Also, a right or obligation is disregarded in the case of stock transferred in connection with the performance of services if it may be exercised only upon the holder's separation from service.

The following exchanges are excluded from this gain recognition: (1) certain exchanges of preferred stock for comparable preferred stock of the same or lesser value; (2) an exchange of preferred stock for common stock; (3) certain exchanges of debt securities for preferred stock of the same or lesser value; and (4) exchanges of stock in certain recapitalization of family-owned corporations. For this purpose, a family-owned corporation is defined as any corporation if at least 50 percent of the total voting power and value of the stock of such corporation is owned by members of the same family for five years preceding the recapitalization. In addition, a recapitalization does not qualify for the exception if the same family does not own 50 percent of the total voting power and value of the stock throughout the three-year period following the recapitalization. Members of the same family are defined by reference to the definition in section 447(e). Thus, a family includes children, parents, brothers, sisters, and spouses, with a limited attribution for directly and indirectly owned stock of the corporation. Shares held by a family member are treated as not held by a family member to the extent a non-family member had a right, option or agreement to acquire the shares (directly or indirectly, for example, through redemptions by the issuer), or with respect to shares as to which a family member has reduced its risk of loss with respect to the share, for example, through an equity swap. Even though the provision excepts certain family recapitalizations, the special valuation rules of section 2701 for estate and gift tax consequences continue to apply.

An exchange of nonqualified preferred stock for nonqualified preferred stock in an acquiring corporation may qualify for tax-free treatment under section 354, but not section 351. In cases in which both sections 354 and 351 may apply to a transaction, section 354 generally will apply for purposes of this proposal. Thus, in that situation, the exchange would be tax free.

The Treasury Secretary has regulatory authority to (1) apply installment sale-type rules to preferred stock that is subject to this proposal in appropriate cases and (2) prescribe treatment of preferred stock subject to this provision under other provisions of the Code (e.g., secs. 304, 306, 318, and 368(c)). Until regulations are issued, preferred stock that is subject to the proposal shall continue to be treated as stock under other provisions of the Code.

Effective date.—The provision is effective for transactions after June 8, 1997, but will not apply to such transactions (1) made pursuant to a written agreement which was binding on such date and at all times thereafter, (2) described in a ruling request submitted to the Internal Revenue Service on or before such date, or (3) described in a public announcement or filing with the Securities and Exchange Commission on or before such date.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with certain clarifications.

The conference agreement clarifies that nonqualified preferred stock is treated as "boot" under section 351(b). The transferor receiving such stock thus is not treated as receiving nonrecognition treatment under section 351(a). However, the nonqualified preferred stock continues to be treated as stock received by a transferor for purposes of qualification of a transaction under section 351(a), unless and until regulations may provide otherwise.

Thus, for example, if A contributes appreciated property to new corporation X for all the common stock (representing 90 percent of the value and all the voting power) of X stock and B contributes cash for nonqualified preferred stock representing 10 percent of the value of X stock, B has received "boot," but the preferred stock is still treated as stock for purposes of sections 351(a) and 368(c), unless and until Treasury Regulations are issued requiring a different result. Thus, the transaction qualifies for non-recognition under section 351. If B had received other stock in addition to nonqualified preferred stock, B would be required to recognize gain only to the extent of the fair market value of the nonqualified preferred stock B receives.

The conference agreement also clarifies the treatment of certain conversion or exchange rights, by deleting any statutory reference to the existence of a "conversion privilege." The conferees wish to clarify that in no event will a conversion privilege into stock of the issuer automatically be considered to constitute participation in corporate growth to any significant extent. The conferees also wish to clarify that stock that is convertible or exchangeable into stock of a corporation other than the issuer (including, for example, stock of a parent corporation or other related corporation) is not considered to be stock that participates in corporate growth to any significant extent for purposes of the provision.

D. Administrative Provisions

1. Reporting of certain payments made to attorneys (sec. 1031 of the House bill)

Present Law

Information reporting is required by persons engaged in a trade or business and making payments in the course of that trade or business of "rent, salaries, wages, . . . or other fixed or determinable gains, profits, and income" (Code sec. 6041(a)). Treas. reg. sec. 1.6041–1(d)(2) provides that attorney's fees are required to be reported if they are paid by a person in a trade or business in the course of a trade or business. Reporting is required to be done on Form 1099–Misc. If, on the other hand, the payment is a gross amount and it is not known what portion is the attorney's fee, no reporting is required on any portion of the payment.

House Bill

The House bill requires gross proceeds reporting on all payments to attorneys made by a trade or business in the course of that trade or business. It is anticipated that gross proceeds reporting would be required on Form 1099–B (currently used by brokers to report gross proceeds). The only exception to this new reporting requirement would be for any payments reported on either Form 1099-Misc under section 6041 (reports of payment of income) or on Form W–2 under section 6051 (payments of wages).

In addition, the present exception in the regulations exempting from reporting any payments made to corporations will not apply to payments made to attorneys. Treasury regulation section 1.6041–3(c) exempts payments to corporations generally (although payments to most corporations providing medical services must be reported). Reporting will be required under both Code sections 6041 and 6045 (as proposed) for payments to corporations that provide legal services. The exception of Treasury regulation section 1.6041–3(g) exempting from reporting payments of salaries or profits paid or distributed by a partnership to the individual partners would continue to apply to both sections (since these amounts are required to be reported on Form K–1).

First, the provision applies to payments made to attorneys regardless of whether the attorney is the exclusive payee. Second, payments to law firms are payments to attorneys, and therefore are subject to this reporting provision. Third, attorneys are required to promptly supply their TINs to persons required to file these information reports, pursuant to section 6109. Failure to do so could result in the attorney being subject to penalty under section 6723 and the payments being subject to backup withholding under section 3406. Fourth, the IRS should administer this provision so that there is no overlap between reporting under section 6041 and reporting under section 6045. For example, if two payments are simultaneously made to an attorney, one of which represents the attorney's fee and the second of which represents the settlement with the attorney's client, the first payment would be reported under section 6041 and the second payment would not be reported under either section 6041 or section 6045, since it is known that the entire payment represents the settlement with the client (and therefore no portion of it represents income to the attorney).

Effective date.—The provision is effective for payments made after December 31, 1997. Consequently, the first information reports will be filed with the IRS (and copies will be provided to recipients of the payments) in 1999, with respect to payments made in 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Information reporting on persons receiving contract payments from certain Federal agencies (sec. 1032 of the House bill and sec. 831 of the Senate amendment)

Present Law

A service recipient (i.e., a person for whom services are performed) engaged in a trade or business who makes payments of remuneration in the course of that trade or business to any person for services performed must file with the IRS an information return reporting such payments (and the name, address, and taxpayer identification number of the recipient) if the remuneration paid to the person during the calendar year is $600 or more (sec. 6041A(a)). A similar statement must also be furnished to the person to whom such payments were made (sec. 6041A(e)). Treasury regulations explicitly exempt from this reporting requirement payments made to a corporation (Treas. reg. sec. 1.6041A–1(d)(2)).

The head of each Federal executive agency must file an information return indicating the name, address, and taxpayer identification number (TIN) of each person (including corporations) with which the agency enters into a contract (sec. 6050M). The Secretary of the Treasury has the authority to require that the returns be in such form and be made at such time as is necessary to make the returns useful as a source of information for collection purposes. The Secretary is given the authority both to establish minimum amounts for which no reporting is necessary as well as to extend the reporting requirements to Federal license grantors and subcontractors of Federal contracts. Treasury regulations provide that no reporting is required if the contract is for $25,000 or less (Treas. reg. sec. 1.6050M–1(c)(1)(i)).

House Bill

The House bill requires reporting of all payments of $600 or more made by a Federal executive agency to any person (including a corporation) for services. In addition, the provision requires that a copy of the information return be sent by the Federal agency to the recipient of the payment. An exception is provided for certain classified or confidential contracts.

Effective date.—The provision is effective for returns the due date for which (without regard to extensions) is more than 90 days after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Disclosure of tax return information for administration of certain veterans programs (sec. 1033 of the House bill and sec. 832 of the Senate amendment)

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

Among the disclosures permitted under the Code is disclosure to the Department of Veterans Affairs ("DVA") of self-employment tax information and certain tax information supplied to the Internal Revenue Service and Social Security Administration by third parties. Disclosure is permitted to assist DVA in determining eligibility for, and establishing correct benefit amounts under, certain of its needs-based pension, health care, and other programs (sec. 6103(l)(7)(D)(viii)). The income tax returns filed by the veterans themselves are not disclosed to DVA.

The DVA is required to comply with the safeguards currently contained in the Code and in section 1137(c) of the Social Security Act (governing the use of disclosed tax information). These safeguards include independent verification of tax data, notification to the individual concerned, and the opportunity to contest agency findings based on such information.

The DVA disclosure provision is scheduled to expire after September 30, 1998.

House Bill

The House bill permanently extends the DVA disclosure provision.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement extends the DVA disclosure provision through September 30, 2003.

4. Establish IRS continuous levy and improve debt collection (secs. 1034, 1035, and 1036 of the House bill and secs. 834, 835, and 836 of the Senate amendment)

A. Continuous levy

Present Law

If any person is liable for any internal revenue tax and does not pay it within 10 days after notice and demand [16] by the IRS, the IRS may then collect the tax by levy upon all property and rights to property belonging to the person,[17] unless there is an explicit statutory restriction on doing so. A levy is the seizure of the person's property or rights to property. Property that is not cash is sold pursuant to statutory requirements.[18]

In general, a levy does not apply to property acquired after the date of the levy,[19] regardless of whether the property is held by the taxpayer or by a third party (such as a bank) on behalf of a taxpayer. Successive seizures may be necessary if the initial seizure is insufficient to satisfy the liability.[20] The only exception to this rule is for salary and wages.[21] A levy on salary and wages is continuous from the date it is first made until the date it is fully paid or becomes unenforceable.

A minimum exemption is provided for salary and wages.[22] It is computed on a weekly basis by adding the value of the standard deduction plus the aggregate value of personal exemptions to which the taxpayer is entitled, divided by 52.[23] For a family of four for taxable year 1996, the weekly minimum exemption is $325.[24]

House Bill

The House bill amends the Code to provide that a continuous levy is also applicable to non-means tested recurring Federal payments. This is defined as a Federal payment for which eligibility is not based on the income and/or assets of a payee. For example, Social Security payments, which are subject to levy under present law, would become subject to continuous levy.

In addition, the House bill provides that this levy would attach up to 15 percent of any specified payment due the taxpayer. This rule explicitly replaces the other specifically enumerated exemptions from levy in the Code. A continuous levy of up to 15 percent would also apply to unemployment benefits and means-tested public assistance.

The House bill also permits the disclosure of otherwise confidential tax return information to the Treasury Department's Fi-

[16] Notice and demand is the notice given to a person liable for tax stating that the tax has been assessed and demanding that payment be made. The notice and demand must be mailed to the person's last known address or left at the person's dwelling or usual place of business (Code sec. 6303).
[17] Code sec. 6331.
[18] Code secs. 6335–6343.
[19] Code sec. 6331(b).
[20] Code sec. 6331(c).
[21] Code sec. 6331(e).
[22] Code sec. 6334(a)(9).
[23] Code sec. 6334(d).
[24] Standard deduction of $6,700 plus four personal exemptions at $2,550 each equals $16,900, which when divided by 52 equals $325.

nancial Management Service only for the purpose of, and to the extent necessary in, implementing these levy provisions.

Effective date.—The provision is effective for levies issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

B. Modifications of levy exemptions

Present Law

The Code exempts from levy workmen's compensation payments[25] and annuity or pension payments under the Railroad Retirement Act and benefits under the Railroad Unemployment Insurance Act,[26] unemployment benefits[27] and means-tested public assistance.[28]

House Bill

The House bill provides that the following property is not exempt from continuous levy if the Secretary of the Treasury (or his delegate) approves the levy of such property:

(1) workmen's compensation payments;

(2) annuity or pension payments under the Railroad Retirement Act and benefits under the Railroad Unemployment Insurance Act;

(3) unemployment benefits; and

(4) means-tested public assistance.

Effective date.—The provision applies to levies issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except that it does not apply to annuity or pension payments under the Railroad Retirement Act and benefits under the Railroad Unemployment Insurance Act.

Conference Agreement

The conference agreement follows the House bill.

[25] Code sec. 6334(a)(7).
[26] Code sec. 6334(a)(6).
[27] Sec. 6334(a)(4).
[28] Sec. 6334(a)(11).

5. Consistency rule for beneficiaries of trusts and estates (sec. 1037 of the House bill and sec. 833 of the Senate amendment)

Present Law

An S corporation is required to file a return for the taxable year and is required to furnish to its shareholders a copy of certain information shown on such return. The shareholder is required to file its return in a manner that is consistent with the information received from the S corporation, unless the shareholder files with the Secretary of the Treasury a notification of inconsistent treatment (sec. 6037(c)). Similar rules apply in the case of partnerships and their partners (sec. 6222).

The fiduciary of an estate or trust that is required to file a return for any taxable year is required to furnish to beneficiaries certain information shown on such return (generally via a Schedule K–1) (sec. 6034A). In addition, a U.S. person that is treated as the owner of any portion of a foreign trust is required to ensure that the trust files a return for the taxable year and furnishes certain required information to each U.S. person who is treated as an owner of a portion of the trust or who receives any distribution from the trust (sec. 6048(b)). However, rules comparable to the consistency rules that apply to S corporation shareholders and partners in partnerships are not specified in the case of beneficiaries of estates and trusts.

House Bill

Under the House bill, a beneficiary of an estate or trust is required to file its return in a manner that is consistent with the information received from the estate or trust, unless the beneficiary files with its return a notification of inconsistent treatment identifying the inconsistency.

Effective date.—The provision is effective for returns filed after date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

E. Excise Tax Provisions

1. Extension and modification of Airport and Airway Trust Fund excise taxes (sec. 1041 of the House bill and sec. 841 of the Senate amendment)

Present Law

In general.—Excise taxes imposed on commercial air transportation of passengers (10 percent of fare) and cargo (6.25 percent of shipping charge) and on noncommercial aviation fuels (15 cents per gallon on aviation gasoline and 17.5 cents per gallon on jet fuel) are transferred to the Airport and Airway Trust Fund to finance a portion of the cost of programs administered by the Federal Aviation Administration. The Airport and Airway Trust Fund excise taxes are scheduled to expire after September 30, 1997.

Commercial passenger tax.—Domestic passenger transportation is taxed at 10 percent of the fare. There is no special tax rate for flight segments to or from small, rural airports. Application of the 10-percent tax to transportation sold through credit card frequent flyer award and similar arrangements is unclear.

Passengers traveling on domestic flights that connect to or from international flights are not subject to tax. International departures are taxed at $6 per passenger; no tax is imposed on international arrivals.

Travel between the 48 contiguous States and Alaska or Hawaii (and between those two States) is taxed at 10 percent of the fare attributable to U.S.-territorial miles plus a $6 per passenger international departure tax.

Passengers are liable for the tax; air carrier liability is only for collection and remittance to the government. Air carriers deposit collected taxes semimonthly, generally no later than the 10th day of the second semimonthly period after the transportation is deemed sold.

Advertising.—Airlines are required to advertise their fares either tax-inclusive or, if separately stated, to state the pre-tax fare, tax, and total in equal sized type.

General Fund fuels tax.—In addition to the Airport and Airway Trust fuel taxes, aviation fuels used in both commercial and noncommercial aviation are subject to a 4.3-cents-per-gallon excise tax. Revenues from this tax are retained in the General Fund.

House Bill

Extension.—Subject to the modifications described below, the House bill extends the present-law Airport and Airway Trust Fund excise taxes for 10 years, through September 30, 2007.

Commercial passenger tax modifications.—Domestic passenger transportation is taxed at 7.5 percent of the fare *plus* $2 per flight segment. (A flight segment is a flight involving one take-off). The $2 rate increases to $3 in four equal annual increments (1999–2002), and is indexed to the consumer price index ("CPI") thereafter. The House bill specifies that payments for the right to award frequent flyer-type points and similar price reductions through credit card and other arrangements are subject to the 7.5-percent tax rate.

The House bill retains the present-law exemption for passengers traveling on domestic flights that connect to or from international flights. Both international departures and arrivals are taxed at $15.50 per passenger. The $15.50-per-passenger rate is indexed to the CPI after 1998.

Travel between the 48 contiguous States and Alaska or Hawaii (or between those States) is taxed at 7.5 percent of the fare attributable to U.S. territorial miles, plus $2 per flight segment, plus the $15.50 per passenger rate international departure tax.

The House bill imposes secondary liability for tax on air carriers. The House bill also provides two special delays in deposits:

(1) taxes otherwise due in the period August 15–September 30, 1997, are due October 10, 1997; and (2) taxes otherwise due in the period July 1–September 30, 1998, are due October 13, 1998.

Advertising.—The House bill requires airlines to state separately pre-tax fare and tax, with tax being stated in print at least 50 percent the size of print in which fare is stated.

Transfer of General Fund fuels tax revenues.—The House bill transfers revenues from the 4.3-cents-per-gallon fuels tax to the Airport and Airway Trust Fund for taxes received in the Treasury on or after October 1, 1997.

Effective date.—The provisions apply generally to transportation beginning after September 30, 1997, with special rules for (1) prepayments between related parties under credit card and similar arrangements after June 11, 1997, that are related to rights to transportation to be awarded or otherwise distributed after September 30, 1997, and (2) tickets sold after date of enactment and before October 1, 1997 for transportation beginning after September 30, 1997.

Senate Amendment

Extension.—Subject to the modifications described below, the Senate amendment extends the present-law Airport and Airway excise taxes for 10 years, the same period as in the House bill.

Commercial passenger tax modifications.—Domestic passenger transportation is taxed at 10 percent (the same rate as under present law). The Senate amendment also includes a 7.5–percent rate for flight segments to or from airports that enplaned no more than 100,000 passengers in the second preceding calendar year and that either (1) are at least 75 miles from a airport that had more than 100,000 passenger enplanements in that year, or (2) qualify for essential air service subsidies as of the date of the amendment's enactment. The Senate amendment specifies that payments for frequent-flyer-type awards or similar price reductions through credit card and other arrangements are subject to the 10-percent tax.

The Senate amendment taxes passengers traveling on domestic flights that connect to or from international flights the same as other domestic passengers (i.e., at 10 percent of fare, or 7.5 percent for certain rural airport flight segments, for the domestic flight). Both international departures and arrivals are taxed at $8 per passenger. Unlike under the comparable House bill provision, the $8 per passenger rate is not indexed.

Travel between the 48 contiguous States and Alaska or Hawaii (or between those two States) is taxed the same as under present law.

The Senate amendment is the same as the House bill on liability for tax. The Senate amendment provides two special delays in deposits: (1) taxes otherwise due in the period August 15–September 30, 1997, are due October 10, 1997; and (2) taxes otherwise due in the period July 1–September 30, 2001, are due October 10, 2001.

Advertising.—No provision.

Transfer of General Fund fuels tax.—No provision.

Effective date.—The Senate amendment is the same as the House bill, except the credit card prepayment rule applies to payments after June 16, 1997.

Conference Agreement

Extension.—The conference agreement follows the House bill and the Senate amendment (i.e., extends the present-law Airport and Airway Trust Fund excise taxes for 10 years, subject to the modifications described below).

Commercial passenger tax modifications.—The conference agreement follows the House bill's domestic passenger tax structure with the following modifications to the rates:

October 1, 1997–September 30, 1998	9 percent of the fare, plus $1 per domestic flight segment.
October 1, 1998–September 30, 1999	8 percent of the fare, plus $2 per domestic flight segment.
September 30, 1999–December 31, 1999	7.5 percent of the fare, plus $2.25 per domestic flight segment.

After December 31, 1999, the *ad valorem* rate will remain at 7.5 percent. The domestic flight segment component of the tax will increase to $2.50 (January 1, 2000–December 31, 2000), to $2.75 (January 1, 2001–December 31, 2001), and to $3 (January 1, 2002–December 31, 2002). Beginning on January 1, 2003, the $3 rate will be indexed to the CPI as under the House bill.[29]

The conference agreement follows the Senate amendment on the treatment of certain domestic flight segments to and from qualified rural airports, with a modification. Under the conference agreement, the tax rate on these flight segments will be 7.5 percent of fare, with no flight segment rate being imposed on eligible flight segments.

The conference agreement follows the House bill and the Senate amendment provisions extending the tax on international departures and expanding that tax to include international arrivals, with a modification setting the tax rate on both international departures and arrivals at $12 per passenger (indexed to the CPI beginning on January 1, 1999, as under the House bill). The conferees believe this increased tax level is consistent with the user tax principles of the Airport and Airway Trust Fund taxes which include the recovery from international passengers of a greater percentage of the costs those passengers impose on FAA-programs than are collected by the present-law international departure tax, so that purely domestic passengers and the General Fund will not be required to subsidize the costs imposed by international travelers to the extent occurring under present law.

The conference agreement does not include the provision of the Senate amendment extending tax to domestic flights that connect to or from international flights. Rather, those flights will continue to be tax-free when the flights constitute segments of uninterrupted international transportation (i.e., the scheduled interval at any intermediate stop does not exceed 12 hours). If an intermediate stop exceeds 12 hours, subsequent domestic segments are taxed as domestic transportation.

[29] Similar to a provision of the House bill, the conference agreement includes a rule of administrative convenience that there is no change in the number of segment taxes imposed if a passenger's route between two locations is changed (with a resulting change in the number of domestic segments) if there is no change in the fare charged (including no imposition of any additional administrative or other fee associated with the route change).

The conference agreement follows the Senate amendment provision retaining the $6 per passenger rate applicable to the international airspace component of flights between the 48 contiguous States and Alaska or Hawaii (or to flights between Alaska and Hawaii).[30] For example, a passenger traveling from Los Angeles to Honolulu in December 1997 would be taxed at 9 percent of the fare applicable to U.S. territorial miles plus $1 per flight segment plus $6. As with the general $12 international arrival and departure rate, this $6-per-passenger rate will be indexed to the CPI beginning on January 1, 1999.

The conference agreement follows the House bill and Senate amendment provisions clarifying that the air passenger excise tax applies to payments to air carriers (and related parties) for the right to award air travel benefits. The tax rate is 7.5 percent. Examples of such taxable payments include (1) payments for frequent flyer miles (including other rights to air transportation) purchased by credit card companies, telephone companies, rental car companies, television networks, restaurants and hotels, air carriers and related parties, and other businesses, and (2) amounts received by air carriers (or related parties) pursuant to joint venture credit card or other marketing arrangements. The conference agreement includes an exception to this general rule in the case of payments for air transportation rights between corporations that are members of a 100 percent commonly owned controlled group (e.g., transportation purchased from an air carrier by a 100 percent commonly owned corporation operating a frequent flyer award program for the air carrier).

The conferees are aware that consumers accrue mileage awards from numerous sources, including actual air travel as well as programs giving rise to taxable payments under this provision of the conference agreement. Once awarded to consumers, these miles are commingled in the consumer's account such that any miles used for a specific purpose may not be traceable to the source which gave rise to them. The conference agreement authorizes the Treasury Department to develop regulations excluding from the tax base a portion of otherwise taxable payments, if any, with respect to awarded frequent flyer miles if the Treasury determines that a portion properly can be allocated (traced) to miles which are used by consumers for purposes other than air transportation. Miles that are unused should not be treated as used for purposes other than air transportation. As part of any rulemaking process it undertakes, the Treasury is authorized to review airline frequent flyer programs and other information from all available sources, including industry and third-party data, in determining whether mileage awards can be adequately traced to support tax-base allocations based on the ultimate use of the awards. The conferees intend that an adjustment to the tax base will be prescribed only if the Treasury finds a consistent pattern of non-air transportation usage by consumers at levels indicating that significant mileage awarded pursuant to payments taxable under this provision is being used for purposes other than air transportation. In making

[30] In contrast, transportation between Alaska or Hawaii and foreign countries (including U.S. possessions) is taxed exclusively as international travel, subject to the $12 per passenger arrival and departure tax.

any such adjustment, the Treasury Department should treat mileage used for non-air transportation purposes as coming first from mileage awarded to consumers from actual air travel (and other sources not subject to tax under this provision).

The conference agreement follows the House bill and the Senate amendment provisions extending secondary liability for the passenger taxes to air carriers.

The conference agreement includes the provision of the House bill changing certain commercial air passenger excise tax deposit dates for taxes otherwise due after August 14, 1997, and before October 1, 1997, to October 10, 1997. Additionally, the conference agreement provides that deposits of commercial air passenger taxes that otherwise would be required after August 14, 1998, and before October 1, 1998, will be due on October 5, 1998. Deposits of the commercial air cargo and aviation fuels taxes that otherwise would be required to be made after July 31, 1998, and before October 1, 1998, will be due on October 5, 1998.

Advertising.—The conference agreement does not include the House bill provision changing the rules governing airline fare advertising.

Transfer of General Fund fuels tax revenues.—The conference agreement includes the House bill provision transferring gross receipts from the 4.3-cents-per-gallon general fund tax on aviation fuels to the Airport and Airway Trust Fund.

Effective date.—The conference agreement follows the House bill.

2. Extend diesel fuel excise tax rules to kerosene (sec. 1042 of the House bill)

Present Law

Diesel fuel is taxed at 24.3 cents per gallon when the fuel is removed from a registered terminal storage facility *unless* the fuel is dyed and is destined for a nontaxable use.

Kerosene is taxed at the wholesale level if it is sold as an aviation fuel. If kerosene is blended with diesel fuel, tax is due from the blender unless the kerosene, and the diesel fuel with which it is blended, are dyed and destined for a nontaxable use.

House Bill

The diesel fuel tax rules are extended to kerosene, with the following modifications:

(1) Undyed kerosene can be removed from terminals without tax by registered aviation wholesalers;

(2) Undyed kerosene can be removed from terminals by pipeline without tax for use as an industrial feedstock (and other than by pipeline as permitted in Treasury Department rules for such a use); and

(3) Expedited refunds to ultimate vendors are allowed for tax-paid kerosene sold for use in space heaters.

Effective date.—July 1, 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill with modifications. First, registration as a terminal facility eligible to handle non-tax-paid diesel fuel and kerosene is conditional on the facility offering its customers dyeing for nontaxable sales of diesel fuel and kerosene. Second, the minimum amount for vendor refunds of tax paid on kerosene is reduced from $200 to $100. Third, the Treasury Department is given regulatory authority to allow tax-free sales of kerosene to wholesale dealers that (a) satisfy such registration and other compliance measures as Treasury may prescribe and (b) sell kerosene exclusively to retailers eligible for refunds with respect to undyed kerosene sold by them for a nontaxable use.

3. Reinstate Leaking Underground Storage Tank Trust Fund excise tax (sec. 1043 of the House bill and sec. 842 of the Senate amendment)

Present Law

Before January 1, 1996, a 0.1-cent-per-gallon excise tax was imposed on gasoline, diesel fuel, special motor fuels, aviation fuels, and inland waterway fuels. Revenues were transferred to a Leaking Underground Storage Tank Trust Fund to finance cleanup of damage from leaking underground storage tanks.

House Bill

The House bill reinstates the tax for approximately five years, from the date of enactment through September 30, 2002.

Effective date.—Date of enactment.

Senate Amendment

The Senate amendment reinstates the tax for 10 years, from October 1, 1997, through September 30, 2007.

Effective date.—Date of enactment.

Conference Agreement

The conference agreement follows the House bill and Senate amendment with a modification to the reinstatement period. The modified period is October 1, 1997, through March 31, 2005.

4. Application of communications excise tax to prepaid telephone cards (sec. 1044 of the House bill and sec. 843 of the Senate amendment)

Present Law

A 3-percent excise tax is imposed on amounts paid for local and toll (long-distance) telephone service and teletypewriter exchange service. The tax is collected by the provider of the service from the consumer (business and personal service).

House Bill

Under the House bill, any amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate long-distance telephone service are treated as amounts paid for taxable communication services, subject to the 3-percent ad valorem tax rate. Examples of such taxable amounts include (1) prepaid telephone cards offered through service stations, convenience stores and other businesses to their customers and others and (2) amounts received by communication service providers pursuant to joint venture credit card or other marketing arrangements. The Treasury Department is authorized specifically to disregard accounting allocations or other arrangements which have the effect of reducing artificially the base to which the 3-percent tax is applied. No inference is intended from this provision as to the proper treatment of these payments under present law.

Effective date.—The provision is effective for amounts paid on or after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with technical modifications. The conference agreement clarifies that any amounts paid to communications service providers (in cash or in kind) for the right to award or otherwise distribute free or reduced-rate telephone service (i.e., local or toll telephone service) are treated as amounts paid for taxable communication services, subject to the 3-percent ad valorem tax rate.

The conference agreement also clarifies that the base to which the communications tax applies in the case of prepaid telephone cards and similar arrangements is the retail value of the service provided by the use of the card or arrangement. The conferees understand that prepaid telephone cards are offered to the public in two forms. The first type of prepaid telephone card can be called a "dollar value card." In this case, the final customer purchases a card or account which allows him to utilize $X worth of telephone service provided by an underlying telecommunications carrier. In this case, following the House bill and the Senate amendment, the conference agreement provides that the 3-percent communications excise tax apply to the value X at the time the prepaid telephone card is sold by a telecommunications carrier to a person who is not a telecommunications carrier.

The second type of prepaid telephone card can be called a "unit card" or a "minute card." In this case the final customer purchases a card or account which allows him to use Y number of units or minutes of telephone service provided by an underlying telecommunications carrier. The conferees intend that the tax applicable to such cards be based on the retail value of the telephone service offered to a consumer and the conference agreement grants the Treasury Department regulatory authority to determine the appropriate retail value. Presently, the Federal Communications Commission generally requires telecommunications carriers to file a tariff listing the prices of their various service offerings including the price of units or minutes offered via prepaid telephone cards. In this case, following the House bill and the Senate amendment, the conference agreement provides that the 3-percent communications excise tax will apply to Y (the number of units or minutes) multiplied by the tariffed price of those units or minutes at the time the prepaid telephone card is sold by a telecommunications carrier to a person who is not a telecommunications carrier. The conferees recognize that such a tariffed value may not in all cases correspond to the over-the-counter price that a final customer may pay for the card. However, the conferees believe that looking to the tariffed price, at present, is the best way to achieve neutral treatment of "dollar cards" and "unit" or "minute cards." The conferees understand that not all prepaid telephone cards may have an underlying tariff that applies to that particular card. In such cases, the conferees intend that tariffs for comparable telephone service be applied if applicable. The conferees believe that tariffs should continue to be filed for service offered via prepaid telephone cards, but if, in the future, tariff filings are not generally filed the conference agreement authorizes the Treasury Department to determine the appropriate retail value of the units or minutes of service offered on such cards.

The conferees understand that sometimes a communications service provider may require certain customers to prepay for their service as assurance that payment is made by the customer for services to be provided. The conferees do not consider such arrangements to constitute payment for communications services for the purposes of this provision if the customer is entitled to a full refund, in cash, for the value of any unused service. The conferees consider such arrangements to be deposits to assure payment of service to be provided in the future.

No inference is intended from this provision as to the proper treatment of payments received by communications service providers for prepaid telephone cards and amounts received by communication service providers pursuant to joint venture credit card or other marketing arrangements under present law.

Effective date.—The conference agreement modifies the effective date so that the provision is effective for cards sold on or after the first day of the month which commences more than 60 days after the date of enactment.

5. Modify treatment of tires under the heavy highway vehicle retail excise tax (sec. 1402 of the House bill and sec. 845 of the Senate amendment)

Present Law

A 12-percent retail excise tax is imposed on certain heavy highway trucks and trailers, and on highway tractors. A separate manufacturers' excise tax is imposed on tires weighing more than 40 pounds. This tire tax is imposed as a fixed dollar amount which varies based on the weight of the tire. Because tires are taxed separately, the value of tires installed on a highway vehicle is excluded from the 12-percent excise tax on heavy highway vehicles.

The determination of value is factual and has given rise to numerous tax audit challenges.

House Bill

The current exclusion of the value of tires installed on a taxable highway vehicle is repealed. Instead, a credit for the amount of manufacturers' excise tax actually paid on the tires is allowed.

Effective date.—The provision is effective after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

6. Increase tobacco excise taxes (sec. 846 of the Senate amendment)

Present Law

The following excise taxes are imposed on tobacco products:

Cigarettes—
- Small cigarettes—24 cents/pack of 20
- Large cigarettes—$25.20/1000

Cigars—
- Large cigars—12.75% of mfgr. price, up to $30/1000
- Small cigars—$1.125/1000

Cigarette papers—$0.0075/50 papers
Cigarette tubes—$0.15/50 tubes
Chewing tobacco—$0.12/lb.
Snuff—$0.36/lb.
Pipe tobacco—$0.675/lb.

House Bill

No provision.

Senate Amendment

The Senate amendment increases the small cigarette tax rate by 20 cents per pack of 20 (i.e., to 44 cents per pack), and increases the tax rates on other tobacco products proportionately. The Senate amendment also extends the tax to "roll-your-own" cigarette tobacco at $0.66/lb., and includes compliance provisions for untaxed cigarettes destined for export.

Floor stocks taxes are imposed on cigarettes and other currently taxed tobacco products held for sale on October 1, 1997 (including articles held in foreign trade zones).

Effective date.—October 1, 1997.

Conference Agreement

The conference agreement on H.R. 2014 does not include the Senate amendment. However, the conference agreement on H.R. 2015 follows the Senate amendment, with modifications. First, the tax rate on small cigarettes is increased by $5 per thousand (10 cents per pack of 20 cigarettes) and the tax rates on other currently taxed tobacco products are increased proportionately beginning on January 1, 2000. On January 1, 2002, the small cigarette tax rate is increased by an additional $2.50 per thousand (5 cents per pack) with the tax rates on other currently taxed tobacco products also being increased proportionately at that time. Thus, the aggregate tax increase on small cigarettes is 15 cents per pack of 20 cigarettes. The conference agreement imposes tax on "roll-your-own" tobacco at the same rate as pipe tobacco.

The conference agreement includes a technical amendment to H.R. 2015, which provides that an amount equal to the increase in tobacco excise taxes included in H.R. 2015 will be credited against total payments made by parties pursuant to future Federal legislation implementing the proposed tobacco industry settlement agreement of June 20, 1997.

Effective date.—The conference agreement on H.R. 2015 is effective on the date of enactment for tobacco products removed after December 31, 1999, and December 31, 2001, respectively. Appropriate floor stocks taxes are imposed on January 1, 2000, and on January 1, 2002.

F. Provisions Relating to Tax-Exempt Organizations

1. Extend UBIT rules to second-tier subsidiaries and amend control test (sec. 1051 of the House bill and sec. 851 of the Senate amendment)

Present Law

In general, interest, rents, royalties and annuities are excluded from unrelated taxable business income (UBTI) of tax-exempt organizations. However, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as UBTI if such income is received from a taxable or tax-exempt subsidiary that is 80 percent controlled by the parent tax-exempt organization.[31] In the case of a stock subsidiary, the 80 percent control test is met if the parent organization owns 80 percent or more of the voting stock and all other classes of stock of the subsidiary.[32] In the case of a nonstock subsidiary, the applicable Treasury regulations look to factors such as the representation of the parent corporation on the board of directors of the nonstock subsidiary, or the power of the parent corporation to appoint or remove the board of directors of the subsidiary.[33]

The control test under section 512(b)(13) does not, however, incorporate any indirect ownership rules.[34] Consequently, rents, roy-

[31] For this purpose, a "controlled organization" is defined under section 368(c). Under present law, rent, royalty, annuity, and interest payments are treated as UBTI when received by the parent organization based on the percentage of the subsidiary's income that is UBTI (either in the hands of the subsidiary if the subsidiary is tax-exempt, or in the hands of the parent organization if the subsidiary is taxable).

[32] Treas. reg. sec. 1.512(b)–1(l)(4)(I)(a).

[33] Treas. reg. sec. 1.512(b)–l(1)(4)(I)(b).

[34] See PLR 9338003 (June 16, 1993) (holding that because no indirect ownership rules are applicable under section 512(b)(13), rents paid by a second-tier taxable subsidiary are not UBTI to a tax-exempt parent organization). In contrast, an example of an indirect ownership rule can be found in Code section 318. Section 318(a)(2)(C) provides that if 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person

Continued

alties, annuities and interest derived from second-tier subsidiaries generally do not constitute UBTI to the tax-exempt parent organization.[35]

House Bill

The House bill modifies the test for determining control for purposes of section 512(b)(13). Under the House bill, "control" means (in the case of a stock corporation) ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests.

In addition, the House bill applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

The House bill also makes technical modifications to the method provided in section 512(b)(13) for determining how much of an interest, rent, annuity, or royalty payment made by a controlled entity to a tax-exempt organization is includible in the latter organization's UBTI. Such payments are subject to the unrelated business income tax to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity.

Effective date.—The modification of the control test to one based on vote or value, the application of the constructive ownership rules of section 318, and the technical modifications to the flow-through method apply to taxable years beginning after the date of enactment. The reduction of the ownership threshold for purposes of the control test from 80 percent to more than 50 percent applies to taxable years beginning after December 31, 1998.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, except that the effective date is modified to provide temporary transition relief for certain payments. The provision does not apply to payments made during the first two taxable years beginning on or after the date of enactment if such payments are made pursuant to a binding written contract in effect as of June 8, 1997, and at all times thereafter before such payment. In addition, the conference agreement does not include the delayed application of the reduction of the ownership threshold for purposes of the control test from 80 percent to more than 50 percent.

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shall be considered as owning the stock owned, directly or indirectly by or for such corporation, in the proportion the value of the person's stock ownership bears to the total value of all stock in the corporation.

[35] See PLR 9542045 (July 28, 1995) (holding that first-tier holding company and second-tier operating subsidiary were organized with bona fide business functions and were not agents of the tax-exempt parent organization; therefore, rents, royalties, and interest received by tax-exempt parent organization from second-tier subsidiary were not UBTI).

2. Limitation on increase in basis of property resulting from sale by tax-exempt entity to related person (sec. 1052 of the House bill and sec. 852 of the Senate amendment)

Present law

If a tax-exempt entity transfers assets to a controlled taxable entity in a transaction that is treated as a sale, the transferee taxable entity obtains a fair market value basis in the assets. Because the transferor is tax-exempt, no gain is recognized on the transfer except to the extent of certain unrelated business taxable income, if any.

Other provisions of the Code deny certain tax benefits when a transferor and transferee are related parties. For example, losses on sales between related parties are not recognized (sec. 267). As another example, ordinary income treatment, rather than capital gain treatment, is required on a sale of depreciable property between related parties.(sec.1239).

House Bill

In the case of a sale or exchange of property directly or indirectly between a tax-exempt entity and a related person, the basis of the related person in the property will not exceed the adjusted basis of such property immediately before the sale in the hands of the tax-exempt entity, increased by the amount of any gain recognized to the tax-exempt entity under the unrelated business taxable income rules of section 511.

A related person means any person having a relationship to the tax-exempt entity described in section 267(b) or 707(b)(1) (generally, certain more-than-50-percent relationships, with specified attribution rules). For purposes of applying section 267(b)(2), such an entity is treated as if it were an individual.

Effective date.—The provision applies to sales or exchanges after June 8, 1997, except that it will not apply to a sale or exchange made pursuant to a written agreement which was binding on such date and at all times thereafter.

Senate Amendment

The Senate amendment is the same as the House bill, except that it is clarified that the term "tax-exempt entity" for purposes of the provision is defined as in section 168(h)(2)(A), without regard to section 168(h)(2)(A)(iii).

Conference Agreement

The conference agreement does not include the House bill provision or the Senate amendment.

3. Reporting and proxy tax requirements for political and lobbying expenditures of certain tax-exempt organizations (sec. 1053 of the House bill)

Present Law

Section 162(e) denies deductions as a trade or business expense for certain lobbying and political expenditures. Section 162(e)(3) provides a flow-through rule to disallow a deduction for a portion of membership dues or similar payments paid to a tax-exempt organization if the organization notifies the member under section 6033(e) that such portion of the membership dues is allocable to political or lobbying activities engaged in by the organization.

Under section 6033(e), tax-exempt organizations (other than charities described in section 501(c)(3)) that engage in lobbying or political campaign activities must disclose the amount of members' dues allocable to lobbying or political campaign expenditures to their members and to the Internal Revenue Service (IRS), except for certain in-house, de minimis expenses.[36] If an organization fails to meet the disclosure requirement under section 6033(e), then the organization generally is subject to a so-called "proxy tax" equal to 35 percent of the amount of members' dues allowable to lobbying or political campaign expenditures. However, under section 6033(e)(3), organizations are exempt from the disclosure requirements and proxy tax if they can establish to the satisfaction of the Secretary of the Treasury that substantially all dues or other similar amounts received by the organization are not deductible without regard to whether or not the organization conducts lobbying or political campaign activities. In Rev. Proc. 95–35, the IRS announced that all tax-exempt organizations—other than (1) organizations described in section 501(c)(4) that are not veterans organizations, (2) agricultural and horticultural organizations described in section 501(c)(5), and (3) trade associations and other organizations described in section 501(c)(6)—are deemed automatically to qualify for the section 6033(e)(3) exemption from the general disclosure requirements and proxy tax. Rev. Proc. 95–35 further provides that an organization described in section 501(c)(4) or an agricultural or horticultural organization described in section 501(c)(5) qualified for the section 6033(e)(3) exemption if the organization receives at least 90 percent of its dues from (1) members with annual dues of less than $50 or (2) other tax-exempt organizations. Under Rev. Proc. 95–35, a trade association or other organization described in section 501(c)(6) qualifies for the section 6033(e)(3) exemption if the organization receives at least 90 percent of its dues from other tax-exempt organizations.[37]

[36] Such disclosure is not required, however with respect to political expenditures if tax is imposed on the organization with respect to such expenditures under section 527(f) (see sec. 6033(e)(1)(B)(iii)).

[37] In addition, Rev. Proc. 95–35 provides that any organization may establish that it satisfies the section 6033(e)(3) exemption by (1) maintaining records establishing that 90 percent or more of the annual dues paid to the organization are not deductible without regard to whether or not the organization conducts lobbying or political campaign activities, and (2) notifying the IRS that it is described in section 6033(e)(3) on any Form 990 (i.e., annual information return) that it is required to file. Additionally, an organization may request a private letter ruling that the organization is eligible for the section 6033(e)(3) exemption.

House Bill

Section 6033(e)(3) is amended to provide that an exemption from the general disclosure requirements and proxy tax of section 6033(e) is available to a tax-exempt organization if more than 90 percent of the amount of aggregate annual dues (or similar payments) received by the organization are paid by (1) individuals or families whose annual dues (or similar amounts) are less than $100,[38] or (2) tax-exempt entities. For purposes of the provision, all organizations sharing a name, charter, historic affiliation, or similar characteristics and coordinating their activities would be treated as a single entity. As under present law, charities described in section 501(c)(3) are not subject to the section 6033(e) disclosure requirements and proxy tax.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

4. Repeal grandfather rule with respect to pension business of certain insurers (sec. 1054 of the bill and sec. 853 of the Senate amendment)

Present Law

Present law provides that an organization described in section 501(c) (3) or (4) of the Code is exempt from tax only if no substantial part of its activities consists of providing commercial-type insurance. When this rule was enacted in 1986, certain treatment (described below) applied to Blue Cross and Blue Shield organizations providing health insurance that (1) were in existence on August 16, 1986; (2) were determined at any time to be tax-exempt under a determination that had not been revoked; and (3) were tax-exempt for the last taxable year beginning before January 1, 1987 (when the present-law rule became effective), provided that no material change occurred in the structure or operations of the organizations after August 16, 1986, and before the close of 1986 or any subsequent taxable year.

The treatment applicable to such organizations, which became taxable organizations under the provision, is as follows. A special deduction applies with respect to health business equal to 25 percent of the claims and expenses incurred during the taxable year less the adjusted surplus at the beginning of the year. An exception is provided for such organizations from the application of the 20-percent reduction in the deduction for increases in unearned premiums that applies generally to property and casualty insurance companies. A fresh start was provided with respect to changes in

[38] The $100 amount will be indexed for inflation after December 31, 1997 (rounded to the nearest multiple of $5).

accounting methods resulting from the change from tax-exempt to taxable status. Thus, no adjustment was made under section 481 on account of an accounting method change. Such an organization was required to compute its ending 1986 loss reserves without artificial changes that would reduce 1987 income. Thus, any reserve weakening after August 16, 1986 was treated as occurring in the organization's first taxable year beginning after December 31, 1986. The basis of such an organization's assets was deemed to be equal to the amount of the assets' fair market value on the first day of the organization's taxable year beginning after December 31, 1986, for purposes of determining gain or loss (but not for determining depreciation or for other purposes).

Grandfather rules were provided in the 1986 Act relating to the provision. It was provided that the provision does not apply to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business, nor does the provision apply with respect to that portion of the business of Mutual of America which is attributable to pension business. Pension business means the administration of any plan described in section 401(a) of the Code which includes a trust exempt from tax under section 501(a), and plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b) of the Code, any individual retirement plan described in section 408 of the Code, and any eligible deferred compensation plan to which section 457(a) of the Code applies.

House Bill

The House bill repeals the grandfather rules applicable to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business and to that portion of the business of Mutual of America which is attributable to pension business. The Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America are to be treated for Federal tax purposes as life insurance companies.

A fresh start is provided with respect to changes in accounting methods resulting from the change from tax-exempt to taxable status. Thus, no adjustment is made under section 481 on account of an accounting method change. The Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America are required to compute ending 1997 loss reserves without artificial changes that would reduce 1998 income. Thus, any reserve weakening after June 8, 1997, is treated as occurring in the organization's first taxable year beginning after December 31, 1997. The basis of assets of Teachers Insurance Annuity Association and College Retirement Equities Fund and Mutual of America is deemed to be equal to the amount of the assets' fair market value on the first day of the organization's taxable year beginning after December 31, 1997, for purposes of determining gain or loss (but not for determining depreciation or for other purposes).

Effective date.—Taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment repeals only the grandfather rule applicable to that portion of the business of Mutual of America which is attributable to pension business.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the House bill.

G. Foreign Provisions

1. Inclusion of income from notional principal contracts and stock lending transactions under subpart F (sec. 1171 of the House bill and sec. 861 of the Senate amendment)

Present Law

Under the subpart F rules, the U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income."

Foreign personal holding company income generally consists of the following: dividends, interest, royalties, rents and annuities; net gains from sales or exchanges of (1) property that gives rise to the foregoing types of income, (2) property that does not give rise to income, and (3) interests in trusts, partnerships, and REMICs; net gains from commodities transactions; net gains from foreign currency transactions; and income that is equivalent to interest. Income from notional principal contracts referenced to commodities, foreign currency, interest rates, or indices thereon is treated as foreign personal holding company income; income from equity swaps or other types of notional principal contracts is not treated as foreign personal holding company income. Income derived from transfers of debt securities (but not equity securities) pursuant to the rules governing securities lending transactions (sec. 1058) is treated as foreign personal holding company income.

Income earned by a CFC that is a regular dealer in the property sold or exchanged generally is excluded from the definition of foreign personal holding company income. However, no exception is available for a CFC that is a regular dealer in financial instruments referenced to commodities.

A U.S. shareholder of a passive foreign investment company ("PFIC") is subject to U.S. tax and an interest charge with respect to certain distributions from the PFIC and gains on dispositions of the stock of the PFIC, unless the shareholder elects to include in income currently for U.S. tax purposes its share of the earnings of the PFIC. A foreign corporation is a PFIC if it satisfies either a passive income test or a passive assets test. For this purpose, passive income is defined by reference to foreign personal holding company income.

House Bill

The House bill treats net income from all types of notional principal contracts as a new category of foreign personal holding company income. However, income, gain, deduction or loss from a notional principal contract entered into to hedge an item of income in another category of foreign personal holding company income is included in that other category.

The House bill treats payments in lieu of dividends derived from equity securities lending transactions pursuant to section 1058 as another new category of foreign personal holding company income.

The House bill provides an exception from foreign personal holding company income for certain income, gain, deduction, or loss from transactions (including hedging transactions) entered into in the ordinary course of a CFC's business as a regular dealer in property, forward contracts, options, notional principal contracts, or similar financial instruments (including instruments referenced to commodities).

These modifications to the definition of foreign personal holding company income apply for purposes of determining a foreign corporation's status as a PFIC.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The conferees wish to clarify the treatment of notional principal contracts under the provision. Although net income from notional principal contracts is added as a new category of foreign personal holding company income, amounts with respect to a notional principal contract entered into to hedge an item described in another category of foreign personal holding company income are taken into account under the rules of such other category. In this regard, gains and losses from transactions in inventory property are covered by an exclusion from the category of personal holding company income for net gains from property transactions; income from a notional principal contract entered into to hedge inventory property is taken into account under such category and thus similarly is excluded from foreign personal holding company income.

2. Restrict like-kind exchange rules for certain personal property (sec. 1172 of the House bill and sec. 862 of the Senate amendment)

Present Law

An exchange of property, like a sale, generally is a taxable event. However, no gain or loss is recognized if property held for productive use in a trade or business or for investment is exchanged for property of a "like-kind" which is to be held for productive use in a trade or business or for investment (sec. 1031). In general, any kind of real estate is treated as of a like-kind with other real property as long as the properties are both located either within or both outside the United States. In addition, certain types of property, such as inventory, stocks and bonds, and partnership interests, are not eligible for nonrecognition treatment under section 1031.

If section 1031 applies to an exchange of properties, the basis of the property received in the exchange is equal to the basis of the property transferred, decreased by any money received by the taxpayer, and further adjusted for any gain or loss recognized on the exchange.

House Bill

The House bill provides that personal property predominantly used within the United States and personal property predominantly used outside the United States are not "like-kind" properties. For this purpose, the use of the property surrendered in the exchange will be determined based upon the use during the 24 months immediately prior to the exchange. Similarly, for section 1031 to apply, property received in the exchange must continue in the same use (i.e., foreign or domestic) for the 24 months immediately after the exchange.

The 24-month period is reduced to such lesser time as the taxpayer held the property, unless such shorter holding period is a result of a transaction (or series of transactions) structured to avoid the purposes of the provision. Property described in section 168(g)(4) (generally, property used both within and without the United States that is eligible for accelerated depreciation as if used in the United States) will be treated as property predominantly used in the United States.

Effective date.—The provision is effective for exchanges after June 8, 1997, unless the exchange is pursuant to a binding contract in effect on such date and all times thereafter. A contract will not fail to be considered to be binding solely because (1) it provides for a sale in lieu of an exchange or (2) either the property to be disposed of as relinquished property or the property to be acquired as replacement property (whichever is applicable) was not identified under the contract before June 9, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Impose holding period requirement for claiming foreign tax credits with respect to dividends (sec. 1173 of the House bill and sec. 863 of the Senate amendment)

Present Law

A U.S. person that receives a dividend from a foreign corporation generally is entitled to a credit for foreign income taxes paid on the dividend, regardless of the shareholder's holding period for the stock. If a regulated investment company ("RIC") elects, U.S. persons that receive dividends from the RIC generally are entitled to an indirect credit for foreign taxes paid by the RIC, regardless of the shareholder's holding period for the RIC stock. A U.S. corporation that receives a dividend from a foreign corporation in which it has a 10-percent or greater voting interest generally is entitled to an indirect credit for foreign taxes paid by the foreign corporation, also regardless of the shareholder's holding period.

House Bill

The House bill disallows the foreign tax credits normally available with respect to a dividend from a corporation or RIC if the shareholder has not held the stock for 16 days in the case of common stock and 46 days in the case of preferred stock. The disallowance applies both to foreign tax credits for foreign withholding taxes that are paid on the dividend where the dividend-paying stock is held for less than these holding periods and to indirect foreign tax credits for taxes paid by a lower-tier foreign corporation or a RIC where any of the required stock in the chain of ownership is held for less than these holding periods. Periods during which a taxpayer is protected from risk of loss generally are not counted toward the holding period requirement. In the case of a bona fide contract to sell stock, a special rule applies for purposes of indirect foreign tax credits. The House bill also provides an exception for foreign active securities dealers.

Effective date.—The provision is effective for dividends paid or accrued more than 30 days after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill with one modification. Under the Senate amendment, the special rule for contracts to sell stock does not apply to indirect foreign tax credits of a RIC shareholder.

Conference Agreement

The conference agreement generally follows the Senate amendment with one modification. The conference agreement grants regulatory authority to the Secretary of the Treasury to treat certain foreign taxes as not subject to the provision. The conferees anticipate that this authority may be used to address internal withholding taxes imposed by a foreign country on persons that do business in the foreign country.

4. Penalties for failure to file disclosure of exemption for income from the international operation of ships or aircraft by foreign persons (sec. 1174 of the House bill)

Present Law

The United States generally imposes a 4-percent tax on the U.S.-source gross transportation income of foreign persons that is not effectively connected with the foreign person's conduct of a U.S. trade or business (sec. 887). Foreign persons generally are subject to U.S. tax at regular graduated rates on net income, including transportation income, that is effectively connected with a U.S. trade or business (secs. 871(b) and 882).

Transportation income is any income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel or aircraft (or a container used in connection therewith) or the performance of services directly related to such use (sec. 863(c)(3)). Income attributable to transportation that begins and ends in the United States is treated as derived from sources in the United States (sec. 863(c)(1)). In the case of transportation that either begins or ends in the United States, generally 50 percent of such income is treated as U.S. source and 50 percent is treated as foreign source (sec. 863(c)(2)). U.S.-source transportation income is treated as effectively connected with a foreign person's conduct of U.S. trade or business only if the foreign person has a fixed place of business in the United States that is involved in the earning of such income and substantially all of such income of the foreign person is attributable to regularly scheduled transportation (sec. 887(b)(4)).

An exemption from U.S. tax is provided for income derived by a nonresident alien individual or foreign corporation from the international operation of a ship or aircraft, provided that the foreign country in which such individual is resident or such corporation is organized grants an equivalent exemption to individual residents of the United States or corporations organized in the United States (secs. 872(b) (1) and (2) and 883(a) (1) and (2)).

Pursuant to guidance published by the Internal Revenue Service, a nonresident alien individual or foreign corporation that is entitled to an exemption from U.S. tax for its income from the international operation of ships or aircraft must file a U.S. income tax return and must attach to such return a statement claiming the exemption (Rev. Proc. 91–12, 1991–1 C.B. 473). If the foreign person is claiming an exemption based on an applicable income tax treaty, the foreign person must disclose that fact as required by the Secretary of the Treasury (sec. 6114). The penalty for failure to make disclosure of a treaty-based position as required under section 6114 is $1,000 for an individual and $10,000 for a corporation (sec. 6712).

House Bill

Under the House bill, a foreign person that claims exemption from U.S. tax for income from the international operation of ships or aircraft, but does not satisfy the filing requirements for claiming such exemption, is subject to the penalty of the denial of such exemption and any deductions or credits otherwise allowable in determining the U.S. tax liability with respect to such income. If a foreign person that has a fixed placed of business in the United States fails to satisfy the filing requirements for claiming an exemption from U.S. tax for its income from the international operation of ships or aircraft, such person is subject to the additional penalty that foreign source income from the international operation of ships or aircraft would be treated as effectively connected with the conduct of a U.S. trade or business, but only to the extent that such income is attributable to such fixed place of business in the United

States. Income so treated as effectively connected with a U.S. business is subject to U.S. tax at graduated rates (and is subject to the disallowance of deductions and credits described above). These penalties do not apply in the case of a failure to disclose that is due to reasonable cause. The provision would not apply to the extent the application would be contrary to any treaty obligation of the United States.

The House bill also provides for the provision of information by the U.S. Customs Service to the Secretary of the Treasury regarding foreign-flag ships engaged in shipping to or from the United States.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the provision in the House bill.

5. Limitation on treaty benefits for payments to hybrid entities (sec. 1175 of the House bill and sec. 742 of the Senate amendment)

Present Law

Nonresident alien individuals and foreign corporations (collectively, foreign persons) that are engaged in business in the United States are subject to U.S. tax on the income from such business in the same manner as a U.S. person. In addition, the United States imposes tax on certain types of U.S.-source income, including interest, dividends and royalties, of foreign persons not engaged in business in the United States. Such tax is imposed on a gross basis and is collected through withholding. The statutory rate of this withholding tax is 30 percent. However, most U.S. income tax treaties provide for a reduction in rate, or elimination, of this withholding tax. Treaties generally provide for different applicable withholding tax rates for different types of income. Moreover, the applicable withholding tax rates differ among treaties. The specific withholding tax rates pursuant to a treaty are the result of negotiations between the United States and the treaty partner.

The application of the withholding tax is more complicated in the case of income derived through an entity, such as a limited liability company, that is treated as a partnership for U.S. tax purposes but may be treated as a corporation for purposes of the tax laws of a treaty partner. The Treasury regulations include specific rules that apply in the case of income derived through an entity that is treated as a partnership for U.S. tax purposes. In the case of a payment of an item of U.S. source income to a U.S. partnership, the partnership is required to impose the withholding tax to the extent the item of income is includible in the distributive share of a partner who is a foreign person. Tax-avoidance opportunities may arise in applying the reduced rates of withholding tax provided under a treaty to cases involving income derived through a limited liability company or other hybrid entity (e.g., an entity that is treated as a partnership for U.S. tax purposes but as a corporation for purposes of the treaty partner's tax laws).

Following the passage of the House bill and the Senate amendment, proposed and temporary regulations were issued addressing the application of the reduced rates of withholding tax provided under a treaty in cases involving a hybrid entity. Temp. Treas. reg. sec. 1.894–1T.

House Bill

The House bill limits the availability of a reduced rate of withholding tax pursuant to an income tax treaty in order to prevent tax avoidance. Under the House bill, a foreign person is entitled to a reduced rate of withholding tax under a treaty with a foreign country on an item of income derived through an entity that is a partnership (or is otherwise treated as transparent) for U.S. tax purposes only if such item is treated for purposes of the taxation laws of such foreign country as an item of income of such person. This rule does not apply if the treaty itself contains a provision addressing the applicability of the treaty in the case of income derived through a partnership. Moreover, the rule does not apply if the foreign country imposes tax on an actual distribution of such item of income from such partnership to such person. In this regard, the foreign country will be considered to impose tax on a distribution even though such tax may be reduced or eliminated by reason of deductions or credits otherwise available to the taxpayer.

The House bill addresses a potential tax-avoidance opportunity for Canadian corporations with U.S. subsidiaries that arises because of the interaction between the U.S. tax law, the Canadian tax law, and the income tax treaty between the United States and Canada. Through the use of a U.S. limited liability company, which is treated as a partnership for U.S. tax purposes but as a corporation for Canadian tax purposes, a payment of interest (which is deductible for U.S. tax purposes) may be converted into a dividend (which is excludable for Canadian tax purposes). Accordingly, interest paid by a U.S. subsidiary through a U.S. limited liability company to a Canadian parent corporation would be deducted by the U.S. subsidiary for U.S. tax purposes and would be excluded by the Canadian parent corporation for Canadian tax purposes; the only tax on such interest would be a U.S. withholding tax, which may be imposed at a reduced rate of 10 percent (rather than the full statutory rate of 30 percent) pursuant to the income tax treaty between the United States and Canada. Under the House bill, withholding tax is imposed at the full statutory rate of 30 percent in such case. The provision would not apply if the U.S.-Canadian income tax treaty is amended to include a provision reaching a similar result. In this regard, the United States and Canada recently negotiated a proposed protocol that would amend the provision in the treaty governing cross-border social security payments and this issue could be addressed in the context of that protocol or an additional protocol. Moreover, the provision would not apply if Canada were to impose tax on the Canadian parent on dividends received from the U.S. limited liability company.

It is believed that the provision generally is consistent with U.S. treaty obligations, including the U.S.-Canada treaty. The United States has recognized authority to implement its tax treaties so as to avoid abuses.

Effective date.—The provision is effective upon date of enactment.

Senate Amendment

The Senate amendment provides that the Secretary of the Treasury shall prescribe regulations to determine the extent to which a taxpayer shall be denied benefits under an income tax treaty of the United States with respect to any payment received by, or income attributable to activities of, an entity that is treated as a partnership for U.S. federal income tax purposes (or is otherwise treated as fiscally transparent for such purposes) but is treated as fiscally non-transparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

The Senate amendment addresses the potential tax-avoidance opportunity that may arise in applying the reduced rates of withholding tax provided under a treaty to cases involving income derived through a limited liability company or other hybrid entity (e.g., an entity that is treated as a partnership for U.S. tax purposes but as a corporation for purposes of the treaty partner's tax laws). Such a tax-avoidance opportunity may arise, for example, for Canadian corporations with U.S. subsidiaries because of the interaction between the U.S. tax law, the Canadian tax law, and the income tax treaty between the United States and Canada. Through the use of a U.S. limited liability company, which is treated as a partnership for U.S. tax purposes but as a corporation for Canadian tax purposes, a payment of interest (which is deductible for U.S. tax purposes) may be converted into a dividend (which is excludable for Canadian tax purposes). Accordingly, interest paid by a U.S. subsidiary through a U.S. limited liability company to a Canadian parent corporation would be deducted by the U.S. subsidiary for U.S. tax purposes and would be excluded by the Canadian parent corporation for Canadian tax purposes; the only tax on such interest would be a U.S. withholding tax, which may be imposed at a reduced rate of 10 percent (rather than the full statutory rate of 30 percent) pursuant to the income tax treaty between the United States and Canada. It is expected that the regulations will impose withholding tax at the full statutory rate of 30 percent in such case.

Effective date.—The provision is effective upon date of enactment.

Conference Agreement

The conference agreement generally follows the House bill with a modification to provide regulatory authority to address the availability of treaty benefits in situations that involve hybrid entities but that are not covered by the denial of benefits specifically provided by the provision.

Under the conference agreement, a foreign person is not entitled to a reduced rate of withholding tax under a treaty with a foreign country on an item of income derived through an entity that is treated as a partnership (or is otherwise treated as fiscally transparent) for U.S. tax purposes if (i) such item is not treated for purposes of the taxation laws of such foreign country as an item of income of such person, (ii) the foreign country does not impose tax on an actual distribution of such item of income from such entity to such person, and (iii) the treaty itself does not contain a provision addressing the applicability of the treaty in the case of income derived through a partnership or other fiscally transparent entity. In addition, the conference agreement grants the Secretary of the Treasury authority to prescribe regulations to determine, in situations other than the situation specifically described in the statutory provision, the extent to which a taxpayer shall not be entitled to benefits under an income tax treaty of the United States with respect to any payment received by, or income attributable to activities of, an entity that is treated as a partnership for U.S. federal income tax purposes (or is otherwise treated as fiscally transparent for such purposes) but is treated as fiscally non-transparent for purposes of the tax laws of the jurisdiction of residence of the taxpayer.

The conferees note that on June 30, 1997 the Secretary issued proposed and temporary regulations addressing the availability of treaty benefits in cases involving hybrid entities. The conferees believe that these regulations are consistent with the provision in the conference agreement. The conferees also believe that the provision in the conference agreement and the temporary and proposed regulations are consistent with U.S. treaty obligations. Such provision and such regulations represent interpretations of U.S. treaties clarifying those situations involving hybrid entities in which taxpayers are entitled to treaty benefits and those situations in which they are not.

6. Interest on underpayments that are reduced by foreign tax credit carrybacks (sec. 1176 of the House bill and sec. 865 of the Senate amendment)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate limitations are applied to specific categories of income. The amount of creditable taxes paid or accrued in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and carried forward five years.

For purposes of the computation of interest on overpayments of tax, if an overpayment for a taxable year results from a foreign tax credit carryback from a subsequent taxable year, the overpayment is deemed not to arise prior to the filing date for the subsequent taxable year in which the foreign taxes were paid or accrued (sec. 6611(g)). Accordingly, interest does not accrue on the overpayment prior to the filing date for the year of the carryback that effectively created such overpayment. In *Fluor Corp.* v. *United States,* 35 Fed. Cl. 520 (1996), the court held that in the case of an underpayment of tax (rather than an overpayment) for a taxable year that is eliminated by a foreign tax credit carryback from a subsequent taxable year, interest does not accrue on the underpayment that is eliminated by the foreign tax credit carryback. The Government has filed an appeal in the *Fluor* case.

House Bill

Under the House bill, if an underpayment for a taxable year is reduced or eliminated by a foreign tax credit carryback from a subsequent taxable year, such carryback does not affect the computation of interest on the underpayment for the period ending with the filing date for such subsequent taxable year in which the foreign taxes were paid or accrued. The House bill also clarifies the application of the interest rules of both section 6601 and section 6611 in the case of a foreign tax credit carryback that is triggered by a net operating loss or net capital loss carryback; in such a case, a deficiency is not considered to have been reduced, and an overpayment is not considered to have been created, until the filing date for the subsequent year in which the loss carryback arose. No inference is intended regarding the computation of interest under present law in the case of a foreign tax credit carryback (including a foreign tax credit carryback that is triggered by a net operating loss or net capital loss carryback).

Effective date.—The provision is effective for foreign taxes actually paid or accrued in taxable years beginning after date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

7. Determination of period of limitations relating to foreign tax credits (sec. 1177 of the House bill and sec. 866 of the Senate amendment)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate limitations are applied to specific categories of income. The amount of creditable taxes paid or accrued in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and carried forward five years.

For purposes of the period of limitations on filing claims for credit or refund, in the case of a claim relating to an overpayment attributable to foreign tax credits, the limitations period is ten years from the filing date for the taxable year with respect to which the claim is made. The Internal Revenue Service has taken the position that, in the case of a foreign tax credit carryforward, the period of limitations is determined by reference to the year in which the foreign taxes were paid or accrued (and not the year to which the foreign tax credits are carried) (Rev. Rul. 84–125, 1984–2 C.B. 125). However, the court in *Ampex Corp.* v. *United States,* 620 F.2d 853 (1980), held that, in the case of a foreign tax credit carryforward, the period of limitations is determined by reference to the year to which the foreign tax credits are carried (and not the year in which the foreign taxes were paid or accrued).

House Bill

Under the House bill, in the case of a claim relating to an overpayment attributable to foreign tax credits, the limitations period is determined by reference to the year in which the foreign taxes were paid or accrued (and not the year to which the foreign tax credits are carried). No inference is intended regarding the determination of such limitations period under present law.

Effective date.—The provision is effective for foreign taxes paid or accrued in taxable years beginning after date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

8. Treatment of income from certain sales of inventory as U.S. source (sec. 864 of the Senate amendment)

Present Law

U.S. persons are subject to U.S. tax on their worldwide income. A credit against U.S. tax on foreign source income is allowed for foreign taxes. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Specific rules apply in determining whether income is from U.S. or foreign sources. Income from the sale or exchange of inventory property generally is sourced where the sale occurs. In *Liggett Group, Inc.* v. *Commissioner,* 58 T.C.M. 1167 (1990), the court concluded that a sale of inventory property by a U.S. corporation to U.S. customers gave rise to foreign source income because the sale occurred outside the United States.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, income from a sale of inventory property by a U.S. resident to another U.S. resident for use, consumption, or disposition in the United States is treated as U.S. source income, if the sale is not attributable to an office or other fixed place of business maintained by the seller outside the United States.

Effective date.—The provision is effective for taxable years beginning after date of enactment.

Conference Agreement

The conference agreement does not include the provision in the Senate amendment.

9. Modify foreign tax credit carryover rules (sec. 867 of the Senate amendment)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate foreign tax credit limitations are applied to specific categories of income.

The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and forward five years. The amount carried over may be used as a credit in a carryover year to the extent the taxpayer otherwise has excess foreign tax credit limitation for such year. The separate foreign tax credit limitations apply for purposes of the carryover rules.

House Bill

No provision.

Senate Amendment

The Senate amendment reduces the carryback period for excess foreign tax credits from two years to one year. The amendment also extends the excess foreign tax credit carryforward period from five years to seven years.

Effective date.—The provision applies to foreign tax credits arising in taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement does not include the provision in the Senate amendment.

10. Repeal special exception to foreign tax credit limitation for alternative minimum tax purposes (sec. 868 of the Senate amendment)

Present Law

Present law imposes a minimum tax on a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. 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.

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

The Omnibus Budget Reconciliation Act of 1989 ("1989 Act") provided a special exception to the limitation on the use of the foreign tax credit against the tentative minimum tax. In order to qualify for this exception, a corporation must meet four requirements. First, more than 50 percent of both the voting power and value of the stock of the corporation must be owned by U.S. persons who are not members of an affiliated group which includes such corporation. Second, all of the activities of the corporation must be conducted in one foreign country with which the United States has an income tax treaty in effect and such treaty must provide for the exchange of information between such country and the United States. Third, the corporation generally must distribute to its shareholders all current earnings and profits (except for certain amounts utilized for normal maintenance or capital expenditures related to its existing business). Fourth, all of such distributions which are received by U.S. persons must be utilized by such persons in a U.S. trade or business. This exception applies to taxable years beginning after March 31, 1990 (with a proration rule effective for certain taxable years which include March 31, 1990).

House Bill

No provision.

Senate Amendment

The special exception regarding the use of foreign tax credits for purposes of the alternative minimum tax, as provided by the 1989 Act, is repealed.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

H. Pension and Employee Benefit Provisions

1. Cashout of certain accrued benefits (sec. 917 of the House bill and sec. 879 of the Senate amendment)

Present Law

Under present law, in the case of an employee whose plan participation terminates, a qualified plan may involuntarily "cash out" the benefit (i.e., pay out the balance to the credit of a plan participant without the participant's consent, and, if applicable, the consent of the participant's spouse) if the present value of the benefit does not exceed $3,500. If a benefit is cashed out under this rule and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which benefits were cashed out unless the employee "buys back" the benefit.

Generally, a cash-out distribution from a qualified plan to a plan participant can be rolled over, tax free, to an IRA or to another qualified plan.

House Bill

The House bill increases the limit on involuntary cash outs from $3,500 to $5,000. The $5,000 amount is adjusted for inflation beginning after 1998 in $50 increments.

Effective date.—The provision is effective for plan years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except the Senate amendment also makes a corresponding change to title I of ERISA and provides that the $5,000 amount is adjusted for inflation beginning after 1997 in $50 increments.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, except that the conference agreement does not increase the $5,000 limit for inflation.

2. Election to receive taxable cash compensation in lieu of nontaxable parking benefits (sec. 880 of the Senate amendment)

Present Law

Under present law, up to $165 per month of employer-provided parking is excludable from gross income. In order for the exclusion to apply, the parking must be provided in addition to and not in lieu of any compensation that is otherwise payable to the employee. Employer-provided parking cannot be provided as part of a cafeteria plan.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, no amount is includible in the income of an employee merely because the employer offers the employee a choice between cash and employer-provided parking. The amount of cash offered is includible in income only if the employee chooses the cash instead of parking.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Repeal of excess distribution and excess retirement accumulation taxes (sec. 882 of the Senate amendment)

Present Law

Under present law, a 15-percent excise tax is imposed on excess distributions from qualified retirement plans, tax-sheltered annuities, and individual retirement arrangements ("IRAs"). Excess distributions are generally the aggregate amount of retirement distributions from such plans during any calendar year in excess of $160,000 (for 1997) or 5 times that amount in the case of a lump-sum distribution. The 15-percent excise tax does not apply to distributions received in 1997, 1998, and 1999.

An additional 15-percent estate tax is imposed on an individual's excess retirement accumulations. Excess retirement accumulations are generally the balance in retirement plans in excess of the present value of a benefit that would not be subject to the 15-percent tax on excess distributions.

House Bill

No provision.

Senate Amendment

The Senate amendment repeals both the 15-percent excise tax on excess distributions and the 15-percent estate tax on excess retirement accumulations.

Effective date.—The provision repealing the excess distribution tax is effective with respect to excess distributions received after December 31, 1996. The repeal of the excess accumulation tax is effective with respect to decedents dying after December 31, 1996.

Conference Agreement

The conference agreement follows the Senate amendment.

4. Tax on prohibited transactions (sec. 884 of the Senate amendment)

Present Law

Present law prohibits certain transactions (prohibited transactions) between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries. A two-tier excise tax is imposed on prohibited transactions. The initial level tax is equal to 10- percent of the amount involved with respect to the transaction. If the transaction is not corrected within a certain period, a tax equal to 100 percent of the amount involved may be imposed.

House Bill

No provision.

Senate Amendment

The Senate amendment increases the initial-level prohibited transaction tax from 10 percent to 15 percent.

Effective date.—The provision is effective with respect to prohibited transactions occurring after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

5. Basis recovery rules (sec. 885 of the Senate amendment)

Present Law

Under present law, amounts received as an annuity under a tax-qualified pension plan generally are includible in income in the year received, except to the extent the amount received represents return of the recipient's investment in the contract (i.e., basis). The portion of each annuity payment that represents a return of basis generally is determined by a simplified method. Under this method, the portion of each annuity payment that is a return to basis is equal to the employee's total basis as of the annuity starting date, divided by the number of anticipated payments under a specified table. The number of anticipated payments listed in the table is based on the age of the primary annuitant on the annuity starting date.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the present-law table applies to benefits based on the life of one annuitant. A separate table applies to benefits based on the life of more than one annuitant.

Effective date.—The provision is effective with respect to annuity starting dates after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment. As under the Senate amendment, a separate table applies to benefits based on the life of more than one annuitant, as follows:

Combined age of annuitants	*Number of payments*
Not more than 110	410
More than 110 but not more than 120	360
More than 120 but not more than 130	310
More than 130 but not more than 140	260
More than 140	210

The conference agreement clarifies that the new table applies to benefits based on the life of more than one annuitant, even if the amount of the annuity varies by annuitant. Thus, for example, the new table applies to a 50-percent joint and survivor annuity. The new table does not apply to an annuity paid on a single life merely because it has additional features, e.g., a term certain.

Effective date.—Same as the Senate amendment.

I. Other Revenue-Increase Provisions

1. Phase out suspense accounts for certain large farm corporations (sec. 1061 of the House bill and sec. 871 of the Senate amendment)

Present Law

A corporation (or a partnership with a corporate partner) engaged in the trade or business of farming must use an accrual method of accounting for such activities unless such corporation (or partnership), for each prior taxable year beginning after December 31, 1975, did not have gross receipts exceeding $1 million. If a farm corporation is required to change its method of accounting, the section 481 adjustment resulting from such change is included in gross income ratably over a 10-year period, beginning with the year of change. This rule does not apply to a family farm corporation.

A provision of the Revenue Act of 1987 ("1987 Act") requires a family corporation (or a partnership with a family corporation as a partner) to use an accrual method of accounting for its farming business unless, for each prior taxable year beginning after December 31, 1985, such corporation (and any predecessor corporation) did not have gross receipts exceeding $25 million. A family corporation is one where at least 50 percent of the stock of the corporation is held by one, or in some limited cases, two or three, families.

A family farm corporation that must change to an accrual method of accounting as a result of the 1987 Act provision is required to establish a suspense account in lieu of including the entire amount of the section 481 adjustment in gross income. The initial balance of the suspense account equals the lesser of (1) the section 481 adjustment otherwise required for the year of change, or (2) the section 481 adjustment computed as if the change in method of accounting had occurred as of the beginning of the taxable year preceding the year of change.

The amount of the suspense account is required to be included in gross income if the corporation ceases to be a family corporation. In addition, if the gross receipts of the corporation attributable to farming for any taxable year decline to an amount below the lesser of (1) the gross receipts attributable to farming for the last taxable year for which an accrual method of accounting was not required, or (2) the gross receipts attributable to farming for the most recent taxable year for which a portion of the suspense account was required to be included in income, a portion of the suspense account is required to be included in gross income.

House Bill

The House bill repeals the ability of a family farm corporation to establish a suspense account when it is required to change to an accrual method of accounting. Thus, under the provision, any family farm corporation required to change to an accrual method of accounting would restore the section 481 adjustment applicable to the change in gross income ratably over a 10-year period beginning with the year of change.

In addition, any taxpayer with an existing suspense account is required to restore the account into income ratably over a 20-year period beginning in the first taxable year beginning after June 8, 1997, subject to the present-law requirements to restore such accounts more rapidly. The amount required to be restored to income for a taxable year pursuant to the 20-year spread period shall not exceed the net operating loss of the corporation for the year (in the case of a corporation with a net operating loss) or 50 percent of the net income of the taxpayer for the year (for corporations with taxable income). For this purpose, a net operating loss or taxable income is determined without regard to the amount restored to income under the provision. Any reduction in the amount required to be restored to income is taken into account ratably over the remaining years in the 20-year period or, if applicable, after the end of the 20-year period. Amounts that extend beyond the 20-year period remain subject to the net operating loss and 50-percent-of-taxable income rules. The net operating loss and 50-percent-of-taxable income rules do not apply to restorations of suspense accounts pursuant to present law.

Effective date.—The provision is effective for taxable years ending after June 8, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

In addition, the Senate amendment repeals the present-law requirement to accelerate the recovery of suspense accounts when the gross receipts of the taxpayer decreases.

Conference Agreement

The conference agreement follows the Senate amendment. In addition, the conferees wish to clarify that in the case of a family farm corporation that elects to be an S corporation for a taxable year, the net operating loss and 50 percent of taxable income limitations shall be determined by taking into account all the items of income, gain, deduction and loss of the corporation, whether or not such items are separately stated under section 1366.

2. Modify net operating loss carryback and carryforward rules (sec. 1062 of the House bill, and sec. 872 of the Senate amendment)

Present Law

The net operating loss ("NOL") of a taxpayer (generally, the amount by which the business deductions of a taxpayer exceeds its gross income) may be carried back three years and carried forward 15 years to offset taxable income in such years. A taxpayer may elect to forgo the carryback of an NOL. Special rules apply to real estate investment trusts ("REITs") (no carrybacks), specified liability losses (10-year carryback), and excess interest losses (no carrybacks).

House Bill

The House bill limits the NOL carryback period to two years and extends the NOL carryforward period to 20 years. The House bill does not apply to the carryback rules relating to REITs, specified liability losses, excess interest losses, and corporate capital losses. In addition, the House bill does not apply to NOLs arising from casualty losses of individual taxpayers.

Effective date.—The provision is effective for NOLs arising in taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment follows the House bill. In addition, the Senate amendment preserves the 3-year carryback for NOLs of farmers and small businesses attributable to losses incurred in Presidentially declared disaster areas.

Conference Agreement

The conference agreement follows the Senate amendment.

3. Expand the limitations on deductibility of premiums and interest with respect to life insurance, endowment and annuity contracts (sec. 1063 of the House bill and sec. 873 of the Senate amendment)

Present Law

Exclusion of inside buildup and amounts received by reason of death

No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup").[39] Further, an exclusion from Federal income tax is provided for amounts received under a life insurance contract paid by reason of the death of the insured (sec. 101(a)).

Premium deduction limitation

No deduction is permitted for premiums paid on any life insurance policy covering the life of any officer or employee, or of any person financially interested in any trade or business carried on by the taxpayer, when the taxpayer is directly or indirectly a beneficiary under such policy (sec. 264(a)(1)).

Interest deduction disallowance with respect to life insurance

Present law provides generally that no deduction is allowed for interest paid or accrued on any indebtedness with respect to one

[39] This favorable tax treatment is available only if the policyholder has an insurable interest in the insured when the contract is issued and if the life insurance contract meets certain requirements designed to limit the investment character of the contract (sec. 7702). Distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income, to the extent that the amounts distributed exceed the taxpayer's basis in the contract; such distributions generally are treated first as a tax-free recovery of basis, and then as income (sec. 72(e)). In the case of a modified endowment contract, however, in general, distributions are treated as income first, loans are treated as distributions (i.e., income rather than basis recovery first), and an additional 10 percent tax is imposed on the income portion of distributions made before age 59-½ and in certain other circumstances (secs. 72(e) and (v)). A modified endowment contract is a life insurance contract that does not meet a statutory "7-pay" test, i.e., generally is funded more rapidly than 7 annual level premiums (sec. 7702A). Certain amounts received under a life insurance contract on the life of a terminally or chronically ill individual, and certain amounts paid by a viatical settlement provider for the sale or assignment of a life insurance contract on the life of a terminally ill or chronically ill individual, are treated as excludable as if paid of the death of the insured (sec. 101(g)).

or more life insurance contracts or annuity or endowment contracts owned by the taxpayer covering any individual who is or was (1) an officer or employee of, or (2) financially interested in, any trade or business currently or formerly carried on by the taxpayer (the "COLI" rules).

This interest deduction disallowance rule generally does not apply to interest on debt with respect to contracts purchased on or before June 20, 1986; rather, an interest deduction limit based on Moody's Corporate Bond Yield Average—Monthly Average Corporates applies in the case of such contracts.[40]

An exception to this interest disallowance rule is provided for interest on indebtedness with respect to life insurance policies covering up to 20 key persons. A key person is an individual who is either an officer or a 20-percent owner of the taxpayer. The number of individuals that can be treated as key persons may not exceed the greater of (1) 5 individuals, or (2) the lesser of 5 percent of the total number of officers and employees of the taxpayer, or 20 individuals. For determining who is a 20-percent owner, all members of a controlled group are treated as one taxpayer. Interest paid or accrued on debt with respect to a contract covering a key person is deductible only to the extent the rate of interest does not exceed Moody's Corporate Bond Yield Average—Monthly Average Corporates for each month beginning after December 31, 1995, that interest is paid or accrued.

The foregoing interest deduction limitation was added in 1996 to existing interest deduction limitations with respect to life insurance and similar contracts.[41]

Interest deduction limitation with respect to tax-exempt interest income

Present law provides that no deduction is allowed for interest on debt incurred or continued to purchase or carry obligations the interest on which is wholly exempt from Federal income tax (sec. 265(a)(2)). In addition, in the case a financial institution, a proration rule provides that no deduction is allowed for that portion of the taxpayer's interest that is allocable to tax-exempt interest (sec. 265(b)). The portion of the interest deduction that is disallowed under this rule generally is the portion determined by the ratio of the taxpayer's (1) average adjusted bases of tax-exempt obligations acquired after August 7, 1986, to (2) the average adjusted bases for all of the taxpayer's assets (sec. 265(b)(2)).[42]

[40] Phase-in rules apply generally with respect to otherwise deductible interest paid or accrued after December 31, 1995, and before January 1, 1999, in the case of debt incurred before January 1, 1996. In addition, transition rules apply.

[41] Since 1942, a limitation has applied to the deductibility of interest with respect to single premium contracts (sec. 264(a)(2)). For this purpose, a contract is treated as a single premium contract if (1) substantially all the premiums on the contract are paid within a period of 4 years from the date on which the contract is purchased, or (2) an amount is deposited with the insurer for payment of a substantial number of future premiums on the contract. Further, under a limitation added in 1964, no deduction is allowed for any amount paid or accrued on debt incurred or continued to purchase or carry a life insurance, endowment, or annuity contract pursuant to a plan of purchase that contemplates the systematic direct or indirect borrowing of part or all of the increases in the cash value of the contract (sec. 264(a)(3)). An exception to the latter rule is provided, permitting deductibility of interest on bona fide debt that is part of such a plan, if no part of 4 of the annual premiums due during the first 7 years is paid by means of debt (the "4-out-of-7 rule") (sec. 264(c)(1)). In addition to the specific disallowance rules of section 264, generally applicable principles of tax law apply.

[42] Special rules apply for certain tax-exempt obligations of small issuers (sec. 265(b)(3)).

House Bill

Expansion of premium deduction limitation to individuals in whom taxpayer has an insurable interest

Under the House bill, the present-law premium deduction limitation is modified to provide that no deduction is permitted for premiums paid on any life insurance, annuity or endowment contract, if the taxpayer is directly or indirectly a beneficiary under the contract.

Expansion of interest disallowance to individuals in whom taxpayer has insurable interest

Under the House bill, no deduction is allowed for interest paid or accrued on any indebtedness with respect to life insurance policy, or endowment or annuity contract, covering the life of any individual. Thus, the provision limits interest deductibility in the case of such a contract covering any individual in whom the taxpayer has an insurable interest when the contract is first issued under applicable State law, except as otherwise provided under present law with respect to key persons and pre-1986 contracts.

Pro rata disallowance of interest on debt to fund life insurance

In the case of a taxpayer other than a natural person, no deduction is allowed for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash surrender values with respect to any life insurance policy or annuity or endowment contract issued after June 8, 1997. Interest expense is so allocable based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, to (2) the average adjusted bases for all assets of the taxpayer. This rule does not apply to any policy or contract owned by an entity engaged in a trade or business, covering any individual who is an employee, officer or director of the trade or business at the time first covered by the policy or contract. Such a policy or contract is not taken into account in determining unborrowed policy cash values.

The unborrowed policy cash values means the cash surrender value of the policy or contract determined without regard to any surrender charge, reduced by the amount of any loan with respect to the policy or contract. The cash surrender value is to be determined without regard to any other contractual or noncontractual arrangement that artificially depresses the cash value of a contract.

If a trade or business (other than a sole proprietorship or a trade or business of performing services as an employee) is directly or indirectly the beneficiary under any policy or contract, then the policy or contract is treated as held by the trade or business. For this purpose, the amount of the unborrowed cash value is treated as not exceeding the amount of the benefit payable to the trade or business. In the case of a partnership or S corporation, the provision applies at the partnership or corporate level. The amount of the benefit is intended to take into account the amount payable to the business under the contract (e.g., as a death benefit) or pursuant to another agreement (e.g., under a split dollar agreement).

The amount of the benefit is intended also to include any amount by which liabilities of the business would be reduced by payments under the policy or contract (e.g., when payments under the policy reduce the principal or interest on a liability owed to or by the business).

As provided in regulations, the issuer or policyholder of the life insurance policy or endowment or annuity contract is required to report the amount of the amount of the unborrowed cash value in order to carry out this rule.

If interest expense is disallowed under other provisions of section 264 (limiting interest deductions with respect to life insurance policies or endowment or annuity contracts) or under section 265 (relating to tax-exempt interest), then the disallowed interest expense is not taken into account under this provision, and the average adjusted bases of assets is reduced by the amount of debt, interest on which is so disallowed. The provision is applied before present-law rules relating to capitalization of certain expenses where the taxpayer produces property (sec. 263A).

An aggregation rule is provided, treating related persons as one for purposes of the provision.

The provision does not apply to any insurance company subject to tax under subchapter L of the Code. Rather, the rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to take into account the increase in cash values of life insurance policies or annuity or endowment contracts held by insurance companies.

Effective date

The provisions apply with respect to contracts issued after June 8, 1997. For this purpose, a material increase in the death benefit or other material change in the contract causes the contract to be treated as a new contract. To the extent of additional covered lives under a contract after June 8, 1997, the contract is treated as a new contract. In the case of an increase in the death benefit of a contract that is converted to extended term insurance pursuant to nonforfeiture provisions, in a transaction to which section 501(d)(2) of the Health Insurance Portability and Accountability Act of 1996 applies, the contract is not treated as a new contract.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with modifications.

Expansion of premium deduction limitation to individuals in whom taxpayer has an insurable interest

The conference agreement provides that the premium deduction limitation does not apply to premiums with respect to any annuity contract described in section 72(s)(5) (relating to certain qualified pension plans, certain retirement annuities, individual retirement annuities, and qualified funding assets), nor to premiums with respect to any annuity to which section 72(u) applies (relating to current taxation of income on the contract in the case of an annuity contract held by a person who is not a natural person).

Expansion of interest disallowance to individuals in whom taxpayer has insurable interest

The conference agreement specifies the treatment of certain interest to which the provision of the bill providing for expansion of interest disallowance to individuals in whom taxpayer has insurable interest otherwise would apply. The conference agreement provides that in the case of a transfer for valuable consideration of a life insurance contract or any interest therein described in section 101(a)(2), the amount of the death benefit excluded from gross income under section 101(a) may not exceed an amount equal to the sum of the actual value of the consideration, premiums, interest disallowed as a deduction under new section 264(a)(4), and other amounts subsequently paid by the transferee. Thus, under the provision, in the case of the transfer for value of a life insurance contract, the interest with respect to the contract that otherwise would be disallowed under new section 264(a)(4) is capitalized, reducing the amount included in income by the transferee upon receipt by the transferee of the amounts paid by reason of the death of the insured.

Pro rata disallowance of interest on debt to fund life insurance

Under the pro rata interest disallowance provision of the bill, the conference agreement provides that interest expense is allocable to unborrowed policy cash values based on the ratio of (1) the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, to (2) the sum of (a) in the case of assets that are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values, and (b) in the case of other assets, the average adjusted bases for all such other assets of the taxpayer.

Under the pro rata interest disallowance rule, the conference agreement expands the exception for any policy or contract owned by an entity engaged in a trade or business, covering an individual who is an employee, officer or director of the trade or business at the time first covered. Under the conference agreement, the exception applies to any policy or contract owned by an entity engaged in a trade or business, which covers one individual who (at the time first insured under the policy or contract) is (1) a 20-percent owner of the entity, or (2) an individual (who is not a 20-percent owner) who is an officer, director or employee of the trade or business. The exception also applies in the case of a joint-life policy or contract under which the sole insureds are a 20-percent owner and the spouse of the 20-percent owner. A joint-life contract under which the sole insureds are a 20-percent owner and his or her spouse is the only type of policy or contract with more than one insured that comes within the exception. Thus, for example, if the insureds under a contract include an individual described in the exception (e.g., an employee, officer, director, or 20-percent owner) and any individual who is not described in the exception (e.g., a debtor of the entity), then the exception does not apply to the policy or contract. For purposes of this exception, a 20-percent owner has the same meaning as under present-law section 264(d)(4). In addition, the conference agreement provides that the pro rata interest disallowance rule does not apply to any annuity contract to which section 72(u) applies (relating to current taxation of income on the contract in the case of an annuity contract held by a person who is not a natural person). The conference agreement provides that any policy or contract that is not subject to the pro rata interest disallowance rule by reason of this exception (for 20-percent owners, their spouses, employees, officers and directors, and in the case of an annuity contract to which section 72(u) applies) is not taken into account in applying the ratio to determine the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values.

The conferees wish to clarify that the aggregation rule (treating related persons as one for purposes of the provision) is intended to prevent taxpayers from avoiding the pro rata interest limitation by owning life insurance, endowment or annuity contracts, while incurring interest expense through a related person.

Treatment of insurance companies

The conference agreement modifies the rules of the provision relating to the reduction of certain deductions of insurance companies. For purposes of those rules, an increase in the policy cash value for any policy or contract is (1) the amount of the increase in the adjusted cash value, reduced by (2) the gross premiums received with respect to the policy or contract during the taxable year, and increased by (3) distributions under the policy or contract to which section 72(e) apply (other than amounts includable in the policyholder's gross income). For this purpose, the adjusted cash value means the cash surrender value of the policy or contract, increased by (1) commissions payable with respect to the policy or contract for the taxable year, and (2) asset management fees, surrender and mortality charges, and any other fees or charges, specified in regulations, which are imposed (or would be imposed if the policy or contract were surrendered or canceled) with respect to the policy or contract for the taxable year.

Effective date

The conferees wish to clarify the rule under the effective date providing that the addition of covered lives is treated as a new contract only with respect to such additional covered lives. It is intended that this rule apply with respect to a master or group policy or contract, not with respect to a joint-life policy or contract (i.e., a policy or contract that insures more than one individual).

4. Allocation of basis of properties distributed to a partner by a partnership (sec. 1064 of the House bill and sec. 874 of the Senate amendment)

Present Law

In general

The partnership provisions of present law generally permit partners to receive distributions of partnership property without recognition of gain or loss (sec. 731).[43] Rules are provided for determining the basis of the distributed property in the hands of the distributee, and for allocating basis among multiple properties distributed, as well as for determining adjustments to the distributee partner's basis in its partnership interest. Property distributions are tax-free to a partnership. Adjustments to the basis of the partnership's remaining undistributed assets are not required unless the partnership has made an election that requires basis adjustments both upon partnership distributions and upon transfers of partnership interests (sec. 754).

Partner's basis in distributed properties and partnership interest

Present law provides two different rules for determining a partner's basis in distributed property, depending on whether or not the distribution is in liquidation of the partner's interest in the partnership. Generally, a substituted basis rule applies to property distributed to a partner in liquidation. Thus, the basis of property distributed in liquidation of a partner's interest is equal to the partner's adjusted basis in its partnership interest (reduced by any money distributed in the same transaction) (sec. 732(b)).

By contrast, generally, a carryover basis rule applies to property distributed to a partner other than in liquidation of its partnership interest, subject to a cap (sec. 732(a)). Thus, in a non-liquidating distribution, the distributee partner's basis in the property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in its partnership interest (reduced by any money distributed in the same transaction). In a non-liquidating distribution, the partner's basis in its partnership interest is reduced by the amount of the basis to the distributee partner of the property distributed and is reduced by the amount of any money distributed (sec. 733).

Allocating basis among distributed properties

In the event that multiple properties are distributed by a partnership, present law provides allocation rules for determining their bases in the distributee partner's hands. An allocation rule is need-

[43] Exceptions to this nonrecognition rule apply: (1) when money (and the fair market value of marketable securities) received exceeds a partner's adjusted basis in the partnership (sec. 731(a)(1)); (2) when only money, inventory and unrealized receivables are received in liquidation of a partner's interest and loss is realized (sec. 731(a)(2)); (3) to certain disproportionate distributions involving inventory and unrealized receivables (sec. 751(b)); and (4) to certain distributions relating to contributed property (secs. 704(c) and 737). In addition, if a partner engages in a transaction with a partnership other than in its capacity as a member of the partnership, the transaction generally is considered as occurring between the partnership and one who is not a partner (sec. 707).

ed when the substituted basis rule for liquidating distributions applies, in order to assign a portion of the partner's basis in its partnership interest to each distributed asset. An allocation rule is also needed in a non-liquidating distribution of multiple assets when the total carryover basis would exceed the partner's basis in its partnership interest, so a portion of the partner's basis in its partnership interest is assigned to each distributed asset.

Present law provides for allocation in proportion to the partnership's adjusted basis. The rule allocates basis first to unrealized receivables and inventory items in an amount equal to the partnership's adjusted basis (or if the allocated basis is less than partnership basis, then in proportion to the partnership's basis), and then among other properties in proportion to their adjusted bases to the partnership (sec. 732(c)).[44] Under this allocation rule, in the case of a liquidating distribution, the distributee partner can have a basis in the distributed property that exceeds the partnership's basis in the property.

House Bill

The House bill modifies the basis allocation rules for distributee partners. It allocates a distributee partner's basis adjustment among distributed assets first to unrealized receivables and inventory items in an amount equal to the partnership's basis in each such property (as under present law).

Under the provision, basis is allocated first to the extent of each distributed property's adjusted basis to the partnership. Any remaining basis adjustment, if an increase, is allocated among properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation (to the extent of each property's appreciation), and then in proportion to their respective fair market values. For example, assume that a partnership with two assets, A and B, distributes them both in liquidation to a partner whose basis in its interest is 55. Neither asset consists of inventory or unrealized receivables. Asset A has a basis to the partnership of 5 and a fair market value of 40, and asset B has a basis to the partnership of 10 and a fair market value of 10. Under the provision, basis is first allocated to asset A in the amount of 5 and to asset B in the amount of 10 (their adjusted bases to the partnership). The remaining basis adjustment is an increase totaling 40 (the partner's 55 basis minus the partnership's total basis in distributed assets of 15). Basis is then allocated to asset A in the amount of 35, its unrealized appreciation, with no allocation to asset B attributable to unrealized appreciation because its fair market value equals the partnership's adjusted basis. The remaining basis adjustment of 5 is allocated in the ratio of the assets' fair market values, i.e., 4 to asset A (for a total basis of 44) and 1 to asset B (for a total basis of 11).

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[44] A special rule allows a partner that acquired a partnership interest by transfer within two years of a distribution to elect to allocate the basis of property received in the distribution as if the partnership had a section 754 election in effect (sec. 732(d)). The special rule also allows the Service to require such an allocation where the value at the time of transfer of the property received exceeds 110 percent of its adjusted basis to the partnership (sec. 732(d)). Treas. Reg. sec. 1.732–1(d)(4) generally requires the application of section 732(d) where the allocation of basis under section 732(c) upon a liquidation of the partner's interest would have resulted in a shift of basis from non-depreciable property to depreciable property.

If the remaining basis adjustment is a decrease, it is allocated among properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation (to the extent of each property's depreciation), and then in proportion to their respective adjusted bases (taking into account the adjustments already made). A remaining basis adjustment that is a decrease arises under the provision when the partnership's total adjusted basis in the distributed properties exceeds the amount of the partner's basis in its partnership interest, and the latter amount is the basis to be allocated among the distributed properties. For example, assume that a partnership with two assets, C and D, distributes them both in liquidation to a partner whose basis in its partnership interest is 20. Neither asset consists of inventory or unrealized receivables. Asset C has a basis to the partnership of 15 and a fair market value of 15, and asset D has a basis to the partnership of 15 and a fair market value of 5. Under the provision, basis is first allocated to the extent of the partnership's basis in each distributed property, or 15 to each distributed property, for a total of 30. Because the partner's basis in its interest is only 20, a downward adjustment of 10 (30 minus 20) is required. The entire amount of the 10 downward adjustment is allocated to the property D, reducing its basis to 5. Thus, the basis of property C is 15 in the hands of the distributee partner, and the basis of property D is 5 in the hands of the distributee partner.

Effective date.—The provision applies to partnership distributions after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Treatment of inventory items of a partnership (sec. 1065 of the House bill and sec. 875 of the Senate amendment)

Present Law

Under present law, upon the sale or exchange of a partnership interest, any amount received that is attributable to unrealized receivables, or to inventory that has substantially appreciated, is treated as an amount realized from the sale or exchange of property that is not a capital asset (sec. 751(a)).

Present law provides a similar rule to the extent that a distribution is treated as a sale or exchange of a partnership interest. A distribution by a partnership in which a partner receives substantially appreciated inventory or unrealized receivables in exchange for its interest in certain other partnership property (or receives certain other property in exchange for its interest in substantially appreciated inventory or unrealized receivables) is treated as a taxable sale or exchange of property, rather than as a nontaxable distribution (sec. 751(b)).

For purposes of these rules, inventory of a partnership generally is treated as substantially appreciated if the fair market value of the inventory exceeds 120 percent of adjusted basis of the inventory to the partnership (sec. 751(d)(1)(A)). In applying this rule, inventory property is excluded from the calculation if a principal purpose for acquiring the inventory property was to avoid the rules relating to inventory (sec. 751(d)(1)(B)).

House Bill

The House bill eliminates the requirement that inventory be substantially appreciated in order to give rise to ordinary income under the rules relating to sales and exchanges of partnership interests and certain partnership distributions. This conforms the treatment of inventory to the treatment of unrealized receivables under these rules.

Effective date.—The provision is effective for sales, exchanges, and distributions after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with modifications. The conference agreement repeals the requirement that inventory be substantially appreciated only with respect to sales or exchanges of partnership interests under section 751(a) of the Code, but not with respect to distributions under section 751(b) of the Code. Thus, present law is retained with respect to distributions governed by section 751(b).

Effective date.—The conference agreement follows the House bill and the Senate amendment, with a modification. The conference agreement provides that the provision is effective for sales, exchanges, and distributions after the date of enactment, except that the provision does not apply to any sale or exchange pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such sale or exchange.

6. Treatment of appreciated property contributed to a partnership (sec. 1066 of the House bill)

Present Law

Under present law, if a partner contributes appreciated property to a partnership, no gain is recognized to the contributing partner at the time of the contribution. The contributing partner's basis in its partnership interest is increased by the basis of the contributed property at the time of the contribution. The pre-contribution gain is reflected in the difference between the partner's capital account and its basis in its partnership interest ("book/tax differential"). Income, gain, loss, and deduction with respect to the contributed property must be shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution (sec. 704(c)(1)(A)).

If the property is subsequently distributed to another partner within 5 years of the contribution, the contributing partner generally recognizes gain as if the property had been sold for its fair market value at the time of the distribution (sec. 704(c)(1)(B)). Similarly, the contributing partner generally includes pre-contribution gain in income to the extent that the value of other property distributed by the partnership to that partner exceeds its adjusted basis in its partnership interest, if the distribution by the partnership is made within 5 years after the contribution of the appreciated property (sec. 737).

House Bill

The House bill extends to 10 years the period in which a partner recognizes pre-contribution gain with respect to property contributed to a partnership. Thus, under the provision, a partner that contributes appreciated property to a partnership generally recognizes pre-contribution gain in the event that the partnership distributes the contributed property to another partner, or distributes to the contributing partner other property whose value exceeds that partner's basis in its partnership interest, if the distribution occurs within 10 years after the contribution to the partnership.

Effective date.—Effective for property contributed to a partnership after June 8, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification. The conference agreement extends to 7 years the period in which a partner recognizes pre-contribution gain with respect to property contributed to a partnership. Thus, under the conference agreement, a partner that contributes appreciated property to a partnership generally recognizes pre-contribution gain in the event that the partnership distributes the contributed property to another partner, or distributes to the contributing partner other property whose value exceeds that partner's basis in its partnership interest, if the distribution occurs within 7 years after the contribution to the partnership.

Effective date.—The effective date is the same as the House bill, with a modification. The conference agreement is effective for property contributed to a partnership after June 8, 1997, except that the provision does not apply to any property contributed to a partnership pursuant to a written binding contract in effect on June 8, 1997, and at all times thereafter before such contribution, if the contract provides for the contribution of a fixed amount of property.

7. Earned income credit compliance provisions (sec. 1067 of the House bill and sec. 5851 of the Senate amendment to H.R. 2015 ("the Balanced Budget Act of 1997"))

Overview

Certain eligible low-income workers are entitled to claim a refundable earned income credit on their income tax return. A refundable credit is a credit that not only reduces an individual's tax liability but allows refunds to the individual in excess of income tax liability. The amount of the credit an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children, and is determined by multiplying the credit rate by the individual's[45] earned income up to an earned income amount. The maximum amount of the credit is the product of the credit rate and the earned income amount. The credit is reduced by the amount of the alternative minimum tax ("AMT") the taxpayer owes for the year. The credit is phased out above certain income levels.

For individuals with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For individuals with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. The definition of AGI used for phasing out the earned income credit disregards certain losses. The losses disregarded are: (1) net capital losses (if greater than zero); (2) net losses from trusts and estates; (3) net losses from nonbusiness rents and royalties; and (4) 50 percent of the net losses from business, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses. Also, an individual is not eligible for the earned income credit if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds $2,250. Disqualified income is the sum of: (1) interest (taxable and tax-exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gain net income; and (5) net passive income (if greater than zero) that is not self-employment income. The earned income amount, the phaseout amount and the disqualified income amount are indexed for inflation.

The parameters for the credit depend upon the number of qualifying children the individual claims. For 1997, the parameters are given in the following table:

PRESENT-LAW EARNED INCOME CREDIT PARAMETERS

	Two or more qualifying children	One qualifying child	No qualifying children
Credit rate (percent)	40.00	34.00	7.65
Earned income amount	$9,140	$6,500	$4,340
Maximum credit	$3,656	$2,210	$332
Phaseout begins	$11,930	$11,930	$5,430

[45] In the case of a married individual who files a joint return with his or her spouse, the income for purposes of these tests is the combined income of the couple.

PRESENT-LAW EARNED INCOME CREDIT PARAMETERS—Continued

	Two or more qualifying children	One qualifying child	No qualifying children
Phaseout rate (percent)	21.06	15.98	7.65
Phaseout ends	$29,290	$25,760	$9,770

In order to claim the credit, an individual must either have a qualifying child or meet other requirements. A qualifying child must meet a relationship test, an age test, an identification test, and a residence test. In order to claim the credit without a qualifying child, an individual must not be a dependent and must be over age 24 and under age 65.

a. Deny EIC eligibility for prior acts of recklessness or fraud (sec. 1067 of the House bill and sec. 5851 of the Senate amendment to H.R. 2015)

Present Law

The accuracy-related penalty, which is imposed at a rate of 20 percent, applies to the portion of any underpayment that is attributable to (1) negligence, (2) any substantial understatement of income tax, (3) any substantial valuation overstatement, (4) any substantial overstatement of pension liabilities, or (5) any substantial estate or gift tax valuation understatement (sec. 6662). Negligence includes any careless, reckless, or intentional disregard of rules or regulations, as well as any failure to make a reasonable attempt to comply with the provisions of the Code.

The fraud penalty, which is imposed at a rate of 75 percent, applies to the portion of any underpayment that is attributable to fraud (sec. 6663).

Neither the accuracy-related penalty nor the fraud penalty is imposed with respect to any portion of an underpayment if it is shown that there was a reasonable cause for that portion and that the taxpayer acted in good faith with respect to that portion.

House Bill

Under the House bill, a taxpayer who fraudulently claims the earned income credit (EIC) is ineligible to claim the EIC for a subsequent period of 10 years. In addition, a taxpayer who erroneously claims the EIC due to reckless or intentional disregard of rules or regulations is ineligible to claim the EIC for a subsequent period of two years. These sanctions are in addition to any other penalty imposed under present law. The determination of fraud or of reckless or intentional disregard of rules or regulations are made in a deficiency proceeding (which provides for judicial review).

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

b. Recertification required when taxpayer found to be ineligible for EIC in past (sec. 1067 of the House bill and sec. 5851 of the Senate amendment to H.R. 2015)

Present law

If an individual fails to provide a correct TIN and claims the EIC, such omission is treated as a mathematical or clerical error. Also, if an individual who claims the EIC with respect to net earnings from self employment fails to pay the proper amount of self-employment tax on such net earnings, the failure is treated as a mathematical or clerical error for purposes of the amount of EIC claimed. Generally, taxpayers have 60 days in which they can either provide a correct TIN or request that the IRS follow the current-law deficiency procedures. If a taxpayer fails to respond within this period, he or she must file an amended return with a correct TIN or clarify that any self-employment tax has been paid in order to obtain the EIC originally claimed.

The IRS must follow deficiency procedures when investigating other types of questionable EIC claims. Under these procedures, contact letters are first sent to the taxpayer. If the necessary information is not provided by the taxpayer, a statutory notice of deficiency is sent by certified mail, notifying the taxpayer that the adjustment will be assessed unless the taxpayer files a petition in Tax Court within 90 days. If a petition is not filed within that time and there is no other response to the statutory notice, the assessment is made and the EIC is denied.

House Bill

Under the House bill, a taxpayer who has been denied the EIC as a result of deficiency procedures is ineligible to claim the EIC in subsequent years unless evidence of eligibility for the credit is provided by the taxpayer. To demonstrate current eligibility, the taxpayer is required to meet evidentiary requirements established by the Secretary of the Treasury. Failure to provide this information when claiming the EIC is treated as a mathematical or clerical error. If a taxpayer is recertified as eligible for the credit, the taxpayer is not required to provide this information in the future unless the IRS again denies the EIC as a result of a deficiency procedure. Ineligibility for the EIC under the provision is subject to review by the courts.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

c. Due diligence requirements for paid preparers (sec. 1067 of the House bill and sec. 5851 of the Senate amendment to H.R. 2015)

Present Law

Several penalties apply in the case of an understatement of tax that is caused by an income tax return preparer. First, if any part of an understatement of tax on a return or claim for refund is attributable to a position for which there was not a realistic possibility of being sustained on its merits and if any person who is an income tax return preparer with respect to such return or claim for refund knew (or reasonably should have known) of such position and such position was not disclosed or was frivolous, then that return preparer is subject to a penalty of $250 with respect to that return or claim (sec. 6694(a)). The penalty is not imposed if there is reasonable cause for the understatement and the return preparer acted in good faith.

In addition, if any part of an understatement of tax on a return or claim for refund is attributable to a willful attempt by an income tax return preparer to understate the tax liability of another person or to any reckless or intentional disregard of rules or regulations by an income tax return preparer, then the income tax return preparer is subject to a penalty of $1,000 with respect to that return or claim (sec. 6694(b)).

Also, a penalty for aiding and abetting the understatement of tax liability is imposed in cases where any person aids, assists in, procures, or advises with respect to the preparation or presentation of any portion of a return or other document if (1) the person knows or has reason to believe that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability of another person would result (sec. 6701).

Additional penalties are imposed on return preparers with respect to each failure to (1) furnish a copy of a return or claim for refund to the taxpayer, (2) sign the return or claim for refund, (3) furnish his or her identifying number, (4) retain a copy or list of the returns prepared, and (5) file a correct information return (sec. 6695). The penalty is $50 for each failure and the total penalties imposed for any single type of failure for any calendar year are limited to $25,000.

House Bill

Under the House bill, return preparers are required to fulfill certain due diligence requirements with respect to returns they prepare claiming the EIC. The penalty for failure to meet these requirements is $100. This penalty is in addition to any other penalty imposed under present law.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

d. Modify the definition of AGI used to phaseout the EIC

Present Law

The EIC is phased out above certain income levels. For individuals with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For individuals with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. The definition of AGI used for the phase out of the earned income credit disregards certain losses. The losses disregarded are: (1) net capital losses (if greater than zero); (2) net losses from trusts and estates; (3) net losses from nonbusiness rents and royalties; and (4) 50 percent of the net losses from business, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement modifies the definition of AGI used for phasing out the credit by adding two items of nontaxable income and changing the percentage of certain losses disregarded. The two items added are: (1) tax-exempt interest, and (2) nontaxable distributions from pensions, annuities, and individual retirement arrangements (but only if not rolled over into similar vehicles during the applicable rollover period). The conference agreement also increases the amount of net losses from businesses, computed separately with respect to sole proprietorships (other than farming), sole proprietorships in farming, and other businesses disregarded from 50 percent to 75 percent.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

8. Eligibility for income forecast method (sec. 1068 of the House bill and sec. 876 of the Senate amendment)

Present Law

A taxpayer generally recovers the cost of property used in a trade or business through depreciation or amortization deductions over time. Tangible property generally is depreciated under the modified Accelerated Cost Recovery System ("MACRS") of section 168, which applies specific recovery periods and depreciation methods to the cost of various types of depreciable property. MACRS does not apply to certain property, including any motion picture film, video tape, or sound recording or to other any property if the taxpayer elects to exclude such property from MACRS and the taxpayer applies a unit-of-production method or other method of depreciation not expressed in a term of years. The cost of such property may be depreciated under the "income forecast" method.

The income forecast method is considered to be a method of depreciation not expressed in a term of years. Under the income forecast method, the depreciation deduction for a taxable year for a property is determined by multiplying the cost of the property (less estimated salvage value) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income to be derived from the property during its useful life. The income forecast method is available to any property if (1) the taxpayer elects to exclude such property from MACRS and (2) for the first taxable year for which depreciation is allowable, the property is properly depreciated under such method. The income forecast method has been held to be applicable for computing depreciation deductions for motion picture films, television films and taped shows, books, patents, master sound recordings and video games. Most recently, the income forecast method has been held applicable to consumer durable property subject to short-term "rent-to-own" leases.

House Bill

The House bill clarifies the types of property to which the income forecast method may be applied. Under the House bill, the income forecast method is available to motion picture films, television films and taped shows, books, patents, master sound recordings, copyrights, and other such property as designated by the Secretary of the Treasury.

In addition, consumer durables subject to rent-to-own contracts are provided a three-year recovery period and a four-year class life for MACRS purposes (and are not eligible for the income forecast method). Such property generally is described in Rev. Proc. 95-38, 1995-34 I.R.B. 25.

Effective date.—The provision is effective for property placed in service after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment, with modifications to depreciation applicable to qualified rent-to-own property. First, the conference agreement provides that the special 3-year recovery period may apply to any property generally used in the home for personal, but not business, use. The conferees understand that certain rent-to-own property, including computer and peripheral equipment, may be used in the home for either personal or business purposes, and the taxpayer may not be aware of how its customers may use the property. So as not to increase the administrative burdens of taxpayers, the conferees intend that if such dual-use property does not represent a significant portion of a taxpayer's leasing property and if such other leasing property predominantly is qualified rent-to-own property, then such dual-use property generally also would be qualified rent-to-own property. However, if such dual-use property represents a significant portion of the taxpayer's leasing property, the conferees intend that the burden of proof be placed on the taxpayer to show that such property is qualified rent-to-own property.

In addition, the conference agreement modifies the definition of "rent-to-own contract" to include leases that provide for decreasing regular periodic payments.

Finally, the conferees wish to clarify that the 3-year recovery period provided under the provision only applies to property subject to leases and no inference is intended as to whether any arrangement constitutes a lease for tax purposes.

9. Require taxpayers to include rental value of residence in income without regard to period of rental (sec. 1069 of the House bill)

Present Law

Gross income for purposes of the Internal Revenue Code generally includes all income from whatever source derived, including rents. The Code (sec. 280A(g)) provides a *de minimis* exception to this rule where a dwelling unit is used during the taxable year by the taxpayer as a residence and such dwelling unit is actually rented for less than 15 days during the taxable year. In this case, the income from such rental is not included in gross income and no deductions arising from such rental use are allowed as a deduction.

House Bill

The House bill repeals the 15-day rules of section 280A(g). The House bill also provides that no reduction in basis is required if the taxpayer (1) rented the dwelling unit for less than 15 days during the taxable year and (2) did not claim depreciation on the dwelling unit for the period of rental.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

10. Modify the exception to the related party rule of section 1033 for individuals to only provide an exception for de minimis amounts (sec. 1070 of the House bill and sec. 877 of the Senate amendment)

Present Law

Under section 1033, gain realized by a taxpayer from certain involuntary conversions of property is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within a specified replacement period of time. Pursuant to a provision of Public Law 104–7, subchapter C corporations (and certain partnerships with corporate partners) are not entitled to defer gain under section 1033 if the replacement property or stock is purchased from a related person. A person is treated as related to another person if the person bears a relationship to the other person described in section 267(b) or 707(b)(1). An exception to this related party rule provides that a taxpayer could purchase replacement property or stock from a related person and defer gain under section 1033 to the extent the related person acquired the replacement property or stock from an unrelated person within the replacement period.

House Bill

The House bill expands the present-law denial of the application of section 1033 to any other taxpayer (including an individual) that acquires replacement property from a related party (as defined by secs. 267(b) and 707(b)(1)) unless the taxpayer has aggregate realized gain of $100,000 or less for the taxable year with respect to converted property with aggregate realized gains. In the case of a partnership (or S corporation), the annual $100,000 limitation applies to both the partnership (or S corporation) and each partner (or shareholder).

Effective date.—The provision applies to involuntary conversions occurring after June 8, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

11. Repeal of exception for certain sales by manufacturers to dealers (sec. 1071 of the House bill and sec. 878 of the Senate amendment)

Present Law

In general, the installment sales method of accounting may not be used by dealers in personal property. Present law provides an exception which permits the use of the installment method for installment obligations arising from the sale of tangible personal property by a manufacturer of the property (or an affiliate of the manufacturer) to a dealer,[46] but only if the dealer is obligated to make payments of principal only when the dealer resells (or rents) the property, the manufacturer has the right to repurchase the property at a fixed (or ascertainable) price after no longer than a 9-month period following the sale to the dealer, and certain other conditions are met. In order to meet the other conditions, the aggregate face amount of the installment obligations that otherwise qualify for the exception must equal at least 50 percent of the total sales to dealers that gave rise to such receivables (the "50-percent test") in both the taxable year and the preceding taxable year, except that, if the taxpayer met all of the requirements for the exception in the preceding taxable year, the taxpayer would not be treated as failing to meet the 50-percent test before the second consecutive year in which the taxpayer did not actually meet the test. In addition, these requirements must be met by the taxpayer in its first taxable year beginning after October 22, 1986, except that obligations issued before that date are treated as meeting the applicable requirements if such obligations were conformed to the requirements of the provision within 60 days of that date.

House Bill

The House bill repeals the exception that permits the use of the installment method of accounting for certain sales by manufacturers to dealers.

Effective date.—The provision is effective for taxable years beginning after the date of enactment. Any resulting adjustment from a required change in accounting will be includible ratably over the 4 taxable years beginning after that date.

Senate Amendment

The Senate amendment is the same as the House bill, except for the effective date.

Effective date.—The provision is effective for taxable years beginning one year after the date of enactment. Any resulting adjustment from a required change in accounting will be includible ratably over the 4 taxable years beginning after that date.

Conference Agreement

The conference agreement follows the Senate amendment.

12. Extension of Federal unemployment surtax (sec. 881 of the Senate amendment)

Present Law

The Federal Unemployment Tax Act (FUTA) imposes a 6.2-percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in States with programs approved by the Federal Government and with no delinquent Federal

[46] I.e., the sale of the property must be intended to be for resale or leasing by the dealer.

loans may credit 5.4-percentage points against the 6.2-percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent. Since all States have approved programs, 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue turned back to them by the 5.4-percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8-percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through 1998.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the temporary surtax rate through December 31, 2007. It also increases the limit from 0.25 percent to 0.50 percent of covered wages on the Federal Unemployment Account (FUA) in the Unemployment Trust Fund.

Effective date.—The provision is effective for labor performed on or after January 1, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

13. Treatment of charitable remainder trusts (sec. 883 of the Senate amendment)

Present Law

In general

Sections 170(f), 2055(e)(2) and 2522(c)(2) disallow a charitable deduction for income, estate or gift tax purposes, respectively, where the donor transfers an interest in property to a charity (e.g., a remainder) while also either retaining an interest in that property (e.g., an income interest) or transferring an interest in that property to a noncharity for less than full and adequate consideration. Exceptions to this general rule are provided for: (1) remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, pooled income funds, farms, and personal residences; (2) present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property; (3) an undivided portion of the donor's entire interest in the property; and (4) a qualified conservation easement.

Charitable remainder annuity trusts and charitable remainder unitrusts

A charitable remainder annuity trust is a trust which is required to pay a fixed dollar amount, not less often than annually, of at least 5 percent of the initial value of the trust to a non-charity for the life of an individual or a period of years not to exceed 20 years, with the remainder passing to charity. A charitable remainder unitrust is a trust which generally is required to pay, at least annually, a fixed percentage of the fair market value of the trust's assets determined at least annually to a noncharity for the life of an individual or a period of years not to exceed 20 years, with the remainder passing to charity (sec. 664(d)).

Distributions from a charitable remainder annuity trust or charitable remainder unitrust are treated first as ordinary income to the extent of the trust's current and previously undistributed ordinary income for the trust's year in which the distribution occurred; second, as capital gains to the extent of the trust's current capital gain and previously undistributed capital gain for the trust's year in which the distribution occurred; third, as other income (e.g., tax-exempt income) to the extent of the trust's current and previously undistributed other income for the trust's year in which the distribution occurred; and, fourth, as corpus (sec. 664(b)).

Distributions are includible in the income of the beneficiary for the year that the annuity or unitrust amount is required to be distributed even though the annuity or unitrust amount is not distributed until after the close of the trust's taxable year. Treas. reg. sec. 1.664–1(d)(4).

On April 18, 1997, the Treasury Department proposed regulations providing additional rules under sections 664 and 2702 to address perceived abuses involving distributions from charitable remainder trusts. One of those proposed rules would require that payment of any required annuity or unitrust amount by a charitable remainder trust (other than an "income only" unitrust) be made by the close of the trust's taxable year in which such payments are due. See Prop. Treas. reg. secs. 1.664–2(a)(1)(i) and 1.664–3(a)(1)(i).

House Bill

No provision.

Senate Amendment

Under the Senate amendment, a trust cannot be a charitable remainder annuity trust if the annuity for any year is greater than 50 percent of the initial fair market value of the trust's assets or be a charitable remainder unitrust if the percentage of assets that are required to be distributed at least annually is greater than 50 percent. Any trust that fails this 50-percent rule will not be a charitable remainder trust whose taxation is governed under section 664, but will be treated as a complex trust and, accordingly, all its income will be taxed to its beneficiaries or to the trust.

Effective date.—The provision applies to transfers to a trust made after June 18, 1997.

Conference Agreement

The conference agreement follows the Senate amendment with a modification that requires that the value of the charitable remainder with respect to any transfer to a qualified charitable remainder annuity trust or charitable remainder unitrust be at least 10 percent of the net fair market value of such property transferred in trust on the date of the contribution to the trust. The 10-percent test is measured on each transfer to the charitable remainder trust and, consequently, a charitable remainder trust which meets the 10-percent test on the date of transfer will not subsequently fail to meet that test if interest rates have declined between the trust's creation and the death of a measuring life. Similarly, where a charitable remainder trust is created for the joint lives of two individuals with a remainder to charity, the trust will not cease to qualify as a charitable remainder trust because the value of the charitable remainder was less than 10 percent of the trust's assets at the first death of those two individuals. The conference agreement provides several additional rules in order to provide relief for trusts that do not meet the 10-percent rule.

First, where a transfer is made after July 28, 1997, to a charitable remainder trust that fails the 10-percent test, the trust is treated as meeting the 10-percent requirement if the governing instrument of the trust is changed by reformation, amendment, construction, or otherwise to meet such requirement by reducing the payout rate or duration (or both) of any noncharitable beneficiary's interest to the extent necessary to satisfy such requirement so long as the reformation is commenced within the period permitted for reformations of charitable remainder trusts under section 2055(e)(3). The statute of limitations applicable to a deficiency of any tax resulting from reformation of the trust shall not expire before the date one year after the Treasury Department is notified that the trust has been reformed. In substance, this rule relaxes the requirements of section 2055(e)(3)(B) to the extent necessary for the reformation for the trust to meet the 10-percent requirement.

Second, a transfer to a trust will be treated as if the transfer never had been made where a court having jurisdiction over the trust subsequently declares the trust void (because, e.g., the application of the 10 percent rule frustrates the purposes for which the trust was created) and judicial proceedings to revoke the trust are commenced within the period permitted for reformations of charitable remainder trusts under section 2055(e)(3). Under this provision, the effect of "unwinding" the trust is that any transactions made by the trust with respect to the property transferred (e.g., income earned on the assets transferred to the trust and capital gains generated by the sales of the property transferred) would be income and capital gain of the donor (or the donor's estate if the trust was testamentary), and the donor (or the donor's estate if the trust was testamentary) would not be permitted a charitable deduction with respect to the transfer. The statute of limitations applicable to a deficiency of any tax resulting from "unwinding" the trust shall not expire before the date one year after the Treasury Department is notified that the trust has been revoked.

Third, where an additional contribution is made after July 28, 1997, to a charitable remainder unitrust created before July 29, 1997, and that unitrust would not meet the 10-percent requirement with respect to the additional contribution, the conference agreement provides that such additional contribution will be treated, under regulations to be issued by the Secretary of the Treasury, as if it had been made to a new trust that does not meet the 10-percent requirement, but which does not affect the status of the original unitrust as a charitable remainder trust.

The conferees intend that this provision of the conference agreement not limit or alter the validity of regulations proposed by the Treasury Department on April 18, 1997, or the Treasury Department's authority to address abuses of the rules governing the taxation of charitable remainder trusts or their beneficiaries.

Effective date.—The requirement that the payout rate not exceed 50 percent applies to transfers to a trust made after June 18, 1997.

The requirement that the value of the charitable remainder with respect to any transfer to a qualified remainder trust be at least 10 percent of the fair market value of the assets transferred in trust applies to transfers to a trust made after July 28, 1997. However, the 10-percent requirement does not apply to a charitable remainder trust created by a testamentary instrument (e.g., a will or revocable trust) executed before July 29, 1997, if the instrument is not modified after that date and the settlor dies before January 1, 1999, or could not be modified after July 28, 1997, because the settlor was under a mental disability on that date (i.e., July 28, 1997) and all times thereafter.

14. Modify general business credit carryback and carryforward rules (sec. 788(b) of the Senate amendment)

Present Law

A qualified taxpayer is allowed to claim the rehabilitation credit, the energy credit, the reforestation credit, the work opportunity credit, the alcohol fuels credit, the research credit, the low-income housing credit, the enhanced oil recovery credit, the disabled access credit, the renewable electricity production credit, the empowerment zone employment credit, the Indian employment credit, the employer social security credit, and the orphan drug credit (collectively, known as the general business credit), subject to certain limitations based on tax liability for the year. Unused general business credits generally may be carried back three years and carried forward 15 years to offset tax liability of such years, subject to the same limitations.

House Bill

No provision.

Senate Amendment

The Senate amendment limits the carryback period for the general business credit to one year and extends the carryforward period to 20 years.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement includes the Senate amendment with a clarification that the provision is effective for credits arising in taxable years beginning after December 31, 1997.

15. Using Federal case registry of child support orders for tax enforcement purposes

Present Law

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 mandated the creation of a Federal Case Registry of Child Support Orders (the FCR) by October 1, 1998. Although HHS has not yet issued final regulations, the FCR is required to include the names, and the State case identification numbers of individuals who are owed or who owe child support or for whom paternity is being established. It may also include the social security numbers (SSNs) of these individuals.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

Not later than October 1, 1999, the Secretary of the Treasury will have access to the Federal Case Registry of Child Support Orders. Also, by October 1, 1999, the data elements on the State Case Registry will include the SSNs of children covered by cases in the Registry, and the States will provide the SSNs of these children to the FCR.

Effective date.— The provision is effective on October 1, 1999.

16. Expanded SSA records for tax enforcement

Present Law

Under the Family Support Act of 1988, States must require each parent to furnish their social security number (SSN) for birth records. Parents can apply directly to the Social Security Administration (SSA) for an SSN for their child; or, in most states, they may apply for the child's SSN when obtaining a birth certificate. On an individual's SSN application, the SSA currently requires the mother's maiden name but not her SSN.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

SSA is required to obtain social security numbers (SSNs) of both parents on minor children's applications for SSNs. The SSA will provide this information to the IRS as part of the Data Master File ("DM-1 file'). The conferees anticipate that the IRS will use the information to identify questionable claims for the earned income credit, the dependent exemption, and other tax benefits, before tax refunds are paid out.

Effective date.—The provision is effective on the date of enactment.

17. Treatment of amounts received under the work requirements of the Personal Responsibility and Work Opportunity Act of 1996

Present Law

Workfare payments

Generally under the Personal Responsibility and Work Opportunity Act of 1996, the receipt of certain government assistance payments is denied unless the recipient meets certain work requirements. The tax treatment of payments received with respect to these work requirements ("workfare payments") was not specified in that legislation.

Earned income credit

Certain eligible low-income workers are entitled to claim a refundable earned income credit on their income tax return. The amount of the credit an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children, and is generally determined by multiplying the credit rate by the individual's earned income up to an earned income amount. The maximum amount of the credit is the product of the credit rate and the earned income amount. The credit is reduced by the amount of the alternative minimum tax ("AMT") the taxpayer owes for the year. The credit is phased out above certain income levels. For individuals with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For individuals with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed. For these purposes, both earned income and AGI are defined to include wages. There is no explicit provision whether workfare payments are wages for purposes of the earned income credit.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement provides that workfare payments are not wages for purposes of the earned income credit. There is no inference intended with respect to whether workfare payments otherwise qualify as wages for purposes of income and employment taxes or as wages for purposes of an employer's eligibility for the work opportunity tax credit and the welfare-to-work tax credit. Also, there is no inference intended with respect to whether workfare payments are wages for purposes of the earned income credit before enactment of this provision.

Effective date.—The provision is effective on the date of enactment.

XI. FOREIGN TAX PROVISIONS

A. General Provisions

1. Simplify foreign tax credit limitation for individuals (sec. 1103 of the House bill and sec. 901 of the Senate amendment)

Present Law

In order to compute the foreign tax credit, a taxpayer computes foreign source taxable income and foreign taxes paid in each of the applicable separate foreign tax credit limitation categories. In the case of an individual, this requires the filing of IRS Form 1116.

In many cases, individual taxpayers who are eligible to credit foreign taxes may have only a modest amount of foreign source gross income, all of which is income from investments. Taxable income of this type ordinarily is includible in the single foreign tax credit limitation category for passive income. However, under certain circumstances, the Code treats investment-type income (e.g., dividends and interest) as income in one of several other separate limitation categories (e.g., high withholding tax interest income or general limitation income). For this reason, any taxpayer with foreign source gross income is required to provide sufficient detail on Form 1116 to ensure that foreign source taxable income from investments, as well as all other foreign source taxable income, is allocated to the correct limitation category.

House Bill

The House bill allows individuals with no more than $300 ($600 in the case of married persons filing jointly) of creditable foreign taxes, and no foreign source income other than passive income, an exemption from the foreign tax credit limitation rules. (It is intended that an individual electing this exemption will not be required to file Form 1116 in order to obtain the benefit of the foreign tax credit.) An individual making this election is not entitled to any carryover of excess foreign taxes to or from a taxable year to which the election applies.

For purposes of this election, passive income generally is defined to include all types of income that is foreign personal holding company income under the subpart F rules, plus income inclusions from foreign personal holding companies and passive foreign investment companies, provided that the income is shown on a payee statement furnished to the individual. For purposes of this election, creditable foreign taxes include only foreign taxes that are shown on a payee statement furnished to the individual.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Simplify translation of foreign taxes (sec. 1104 of the House bill and sec. 902 of the Senate amendment)

Present Law

Translation of foreign taxes

Foreign income taxes paid in foreign currencies are required to be translated into U.S. dollar amounts using the exchange rate as of the time such taxes are paid to the foreign country or U.S. possession. This rule applies to foreign taxes paid directly by U.S. taxpayers, which taxes are creditable in the year paid or accrued, and to foreign taxes paid by foreign corporations that are deemed paid by a U.S. corporation that is a shareholder of the foreign corporation, and hence creditable, in the year that the U.S. corporation receives a dividend or has an income inclusion from the foreign corporation.

Redetermination of foreign taxes

For taxpayers that utilize the accrual basis of accounting for determining creditable foreign taxes, accrued and unpaid foreign tax liabilities denominated in foreign currencies are translated at the exchange rate as of the last day of the taxable year of accrual. If a difference exists between the dollar value of accrued foreign taxes and the dollar value of those taxes when paid, a redetermination of foreign taxes arises. A foreign tax redetermination may occur in the case of a refund of foreign taxes. A foreign tax redetermination also may arise because the amount of foreign currency units actually paid differs from the amount of foreign currency units accrued. In addition, a redetermination may arise due to fluctuations in the value of the foreign currency relative to the dollar between the date of accrual and the date of payment.

As a general matter, a redetermination of foreign tax paid or accrued directly by a U.S. person requires notification of the Internal Revenue Service and a redetermination of U.S. tax liability for the taxable year for which the foreign tax was claimed as a credit. The Treasury regulations provide exceptions to this rule for de minimis cases. In the case of a redetermination of foreign taxes that qualify for the indirect (or "deemed-paid") foreign tax credit under sections 902 and 960, the Treasury regulations generally require taxpayers to make appropriate adjustments to the payor foreign corporation's pools of earnings and profits and foreign taxes.

House Bill

Translation of foreign taxes

Translation of certain accrued foreign taxes

With respect to taxpayers that take foreign income taxes into account when accrued, the House bill generally provides for foreign taxes to be translated at the average exchange rate for the taxable year to which such taxes relate. This rule does not apply (1) to any foreign income tax paid after the date two years after the close of the taxable year to which such taxes relate, (2) with respect to taxes of an accrual-basis taxpayer that are actually paid in a taxable year prior to the year to which they relate, or (3) to tax payments that are denominated in an inflationary currency (as defined by regulations).

Translation of all other foreign taxes

Under the House bill, foreign taxes not eligible for application of the preceding rule generally are translated into U.S. dollars using the exchange rates as of the time such taxes are paid. The House bill provides the Secretary of the Treasury with authority to issue regulations that would allow foreign tax payments to be translated into U.S. dollar amounts using an average exchange rate for a specified period.

Redetermination of foreign taxes

Under the House bill, a redetermination is required if (1) accrued taxes when paid differ from the amounts claimed as credits by the taxpayer; (2) accrued taxes are not paid before the date two years after the close of the taxable year to which such taxes relate; or (3) any tax paid is refunded in whole or in part. Thus, for example, the House bill provides that if at the close of the second taxable year after the taxable year to which an accrued tax relates, any portion of the tax so accrued has not yet been paid, a foreign tax redetermination under section 905(c) is required for the amount representing the unpaid portion of that accrued tax. In other words, the previous accrual of any tax that is unpaid as of that date is denied. In cases where a redetermination is required, as under present law, the bill specifies that the taxpayer must notify the Secretary, who will redetermine the amount of the tax for the year or years affected. In the case of indirect foreign tax credits, regulatory authority is granted to prescribe appropriate adjustments to the foreign tax credit pools in lieu of such a redetermination.

The House bill provides that in the case of accrued taxes not paid within the date two years after the close of the taxable year to which such taxes relate, any such taxes if subsequently paid are taken into account for the taxable year to which such taxes relate. These taxes are translated into U.S. dollar amounts using the exchange rates in effect as of the time such taxes are paid.

For example, assume that in year 1 a taxpayer accrues 1,000 units of foreign tax that relate to year 1 and that the currency involved is not inflationary . Further assume that as of the end of year 1 the tax is unpaid. In this case, the House bill provides that the taxpayer translates 1,000 units of accrued foreign tax into U.S. dollars at the average exchange rate for year 1. If the 1,000 units of tax are paid by the taxpayer in either year 2 or year 3, no redetermination of foreign tax is required. If any portion of the tax so accrued remains unpaid as of the end of year 3, however, the taxpayer is required to redetermine its foreign tax accrued in year 1 to eliminate the accrued but unpaid tax, thereby reducing its foreign tax credit for such year. If the taxpayer pays the disallowed taxes in year 4, the taxpayer again redetermines its foreign taxes (and foreign tax credit) for year 1, but the taxes paid in year 4 are translated into U.S. dollars at the exchange rate for year 4.

Effective date

The provision generally is effective for foreign taxes paid (in the case of taxpayers using the cash basis for determining the foreign tax credit) or accrued (in the case of taxpayers using the accrual basis for determining the foreign tax credit) in taxable years beginning after December 31, 1997. The provision's changes to the foreign tax redetermination rules apply to foreign taxes which relate to taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill with one modification with respect to the treatment of accrued taxes that are paid more than two years after the close of the taxable year to which such taxes relate. In the case of the indirect foreign tax credit, any such taxes are taken into account for the taxable year in which paid, and are translated into U.S. dollar amounts using the exchange rates as of the time such taxes are paid. In the case of the direct foreign tax credit, as under the House bill, any such taxes are taken into account for the taxable year to which such taxes relate, but are translated into U.S. dollar amounts using the exchange rates in effect as of the time such taxes are paid.

Conference Agreement

The conference agreement follows the Senate amendment with one modification. The conference agreement clarifies that the regulatory authority applicable in the case of indirect foreign tax credits allows, in lieu of a redetermination of taxes, appropriate adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings.

3. Election to use simplified foreign tax credit limitation for alternative minimum tax purposes (sec. 1105 of the House bill and sec. 903 of the Senate amendment)

Present Law

Computing foreign tax credit limitations requires the allocation and apportionment of deductions between items of foreign source income and items of U.S. source income. Foreign tax credit limitations must be computed both for regular tax purposes and for purposes of the alternative minimum tax (AMT). Consequently, the allocation and apportionment of deductions must be done separately for regular tax foreign tax credit limitation purposes and AMT foreign tax credit limitation purposes.

House Bill

The House bill permits taxpayers to elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source regular taxable income to entire alternative minimum taxable income, rather than the ratio of foreign source alternative minimum taxable income to entire alternative minimum taxable income. Under this election, foreign source regular taxable income is used, however, only to the extent it does not exceed entire alternative minimum taxable income. In the event that foreign source regular taxable income does exceed entire alternative minimum taxable income, and the taxpayer has income in more than one foreign tax credit limitation category, it is intended that the foreign source taxable income in each such category generally would be reduced by a pro rata portion of that excess.

The election is available only in the first taxable year beginning after December 31, 1997 for which the taxpayer claims an AMT foreign tax credit. It is intended that a taxpayer will be treated, for this purpose, as claiming an AMT foreign tax credit for any taxable year for which the taxpayer chooses to have the benefits of the foreign tax credit and in which the taxpayer is subject to the alternative minimum tax or would be subject to the alternative minimum tax but for the availability of the AMT foreign tax credit. The election, once made, will apply to all subsequent taxable years, and may be revoked only with the consent of the Secretary of the Treasury.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Simplify treatment of personal transactions in foreign currency (sec. 1106 of the House bill and sec. 904 of the Senate amendment)

Present Law

When a U.S. taxpayer makes a payment in a foreign currency, gain or loss (referred to as “exchange gain or loss”) generally arises from any change in the value of the foreign currency relative to the U.S. dollar between the time the currency was acquired (or the obligation to pay was incurred) and the time that the payment is made. Gain or loss results because foreign currency, unlike the U.S. dollar, is treated as property for Federal income tax purposes.

Exchange gain or loss can arise in the course of a trade or business or in connection with an investment transaction. Exchange gain or loss also can arise where foreign currency was acquired for personal use.

House Bill

If an individual acquires foreign currency and disposes of it in a personal transaction and the exchange rate changes between the acquisition and disposition of such currency, the House bill applies nonrecognition treatment to any resulting exchange gain, provided that such gain does not exceed $200. The provision does not change the treatment of resulting exchange losses.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with one modification. The conference agreement clarifies that transactions entered into in connection with a business trip constitute personal transactions for purposes of this provision. Exchange gain resulting from such transactions is eligible for nonrecognition treatment under this provision.

5. Simplify foreign tax credit limitation for dividends from 10/50 companies (sec. 1107 of the House bill)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S. source income. Separate limitations are applied to specific categories of income.

Special foreign tax credit limitation rules apply in the case of dividends received from a foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote and which is not a controlled foreign corporation (a so-called "10/50 company"). Dividends received by the taxpayer from each 10/50 company are subject to a separate foreign tax credit limitation.

House Bill

Under the House bill, a single foreign tax credit limitation generally applies to dividends received by the taxpayer from all 10/50 companies. However, separate foreign tax credit limitations continue to apply to dividends received by the taxpayer from each 10/50 company that qualifies as a passive foreign investment company. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock. To the extent the regulations treat distributions from a foreign corporation out of earnings and profits for pre-acquisition periods as subject to a separate foreign tax credit limitation, it is expected that the regulations would allow the taxpayer to elect to apply that separate foreign tax credit limitation (rather than the limitation applicable to dividends from all 10/50 companies) also to distributions out of post-acquisition earnings and profits of such corporation.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

Senate Amendment

No provision.

Conference Agreement

The conference agreement generally provides for look-through treatment to apply in characterizing dividends from 10/50 companies for foreign tax credit limitation purposes. Under the conference agreement, any dividend from a 10/50 company paid out of earnings and profits accumulated in a taxable year beginning after December 31, 2002 is treated as income in a foreign tax credit limitation category in proportion to the ratio of the earnings and profits attributable to income in such foreign tax credit limitation category to the total earnings and profits. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earning and profits for periods prior to the taxpayer's acquisition of such stock.

In the case of dividends from a 10/50 company paid out of earnings and profits accumulated in a taxable year beginning before January 1, 2003, the conference agreement provides that a single foreign tax credit limitation generally applies to *all* such dividends from all 10/50 companies. However, separate foreign tax credit limitations continue to apply to any such dividends received by the taxpayer from each 10/50 company that qualifies as a passive foreign investment company. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earning and profits for periods prior to the taxpayer's acquisition of such stock.

Effective date.—The provision is effective for taxable years beginning after December 31, 2002.

B. General Provisions Affecting Treatment of Controlled Foreign Corporations (secs. 1111–1113 of the House bill and secs. 911–913 of the Senate amendment)

Present Law

If an upper-tier controlled foreign corporation ("CFC") sells stock of a lower-tier CFC, the gain generally is included in the income of U.S. 10-percent shareholders as subpart F income and such U.S. shareholder's basis in the stock of the first-tier CFC is increased to account for the inclusion. The inclusion is not characterized for foreign tax credit limitation purposes by reference to the nature of the income of the lower-tier CFC; instead it generally is characterized as passive income.

For purposes of the foreign tax credit limitations applicable to so-called 10/50 companies, a CFC is not treated as a 10/50 company with respect to any distribution out of its earnings and profits for periods during which it was a CFC and, except as provided in regulations, the recipient of the distribution was a U.S. 10-percent shareholder in such corporation.

If subpart F income of a lower-tier CFC is included in the gross income of a U.S. 10- percent shareholder, no provision of present law allows adjustment of the basis of the upper-tier CFC's stock in the lower-tier CFC.

The subpart F income earned by a foreign corporation during its taxable year is taxed to the persons who are U.S. 10-percent shareholders of the corporation on the last day, in that year, on which the corporation is a CFC. In the case of a U.S. 10-percent shareholder who acquired stock in a CFC during the year, such inclusions are reduced by all or a portion of the amount of dividends paid in that year by the foreign corporation to any person other than the acquiror with respect to that stock.

As a general rule, subpart F income does not include income earned from sources within the United States if the income is effectively connected with the conduct of a U.S. trade or business by the CFC. This general rule does not apply, however, if the income is exempt from, or subject to a reduced rate of, U.S. tax pursuant to a provision of a U.S. treaty.

A U.S. corporation that owns at least 10 percent of the voting stock of a foreign corporation is treated as if it had paid a share of the foreign income taxes paid by the foreign corporation in the year in which the foreign corporation's earnings and profits become subject to U.S. tax as dividend income of the U.S. shareholder. A U.S. corporation also may be deemed to have paid taxes paid by a second- or third-tier foreign corporation if certain conditions are satisfied.

House Bill

Lower-tier CFCs

Characterization of gain on stock disposition

Under the House bill, if a CFC is treated as having gain from the sale or exchange of stock in a foreign corporation, the gain is treated as a dividend to the same extent that it would have been so treated under section 1248 if the CFC were a U.S. person. This provision, however, does not affect the determination of whether the corporation whose stock is sold or exchanged is a CFC.

Thus, for example, if a U.S. corporation owns 100 percent of the stock of a foreign corporation, which owns 100 percent of the stock of a second foreign corporation, then under the House bill, any gain of the first corporation upon a sale or exchange of stock of the second corporation is treated as a dividend for purposes of subpart F income inclusions to the U.S. shareholder, to the extent of earnings and profits of the second corporation attributable to periods in which the first foreign corporation owned the stock of the second foreign corporation while the latter was a CFC with respect to the U.S. shareholder.

Gain on disposition of stock in a related corporation created or organized under the laws of, and having a substantial part of its assets in a trade or business in, the same foreign country as the gain recipient, even if recharacterized as a dividend under the House bill provision, is not excluded from foreign personal holding company income under the same-country exception that applies to actual dividends.

Under the House bill, for purposes of this rule, a CFC is treated as having sold or exchanged stock if, under any provision of subtitle A of the Code, the CFC is treated as having gain from the sale or exchange of such stock. Thus, for example, if a CFC distributes to its shareholder stock in a foreign corporation, and the distribution results in gain being recognized by the CFC under section 311(b) as if the stock were sold to the shareholder for fair market value, the House bill makes clear that, for purposes of this rule, the CFC is treated as having sold or exchanged the stock.

The House bill also repeals a provision added to the Code by the Technical and Miscellaneous Revenue Act of 1988 that, except as provided by regulations, requires a recipient of a distribution from a CFC to have been a U.S. 10-percent shareholder of that CFC for the period during which the earnings and profits which gave rise to the distribution were generated in order to avoid treating the distribution as one coming from a 10/50 company. Thus, under the House bill, a CFC is not treated as a 10/50 company with respect to any distribution out of its earnings and profits for periods during which it was a CFC, whether or not the recipient of the distribution was a U.S. 10-percent shareholder of the corporation when the earnings and profits giving rise to the distribution were generated.

Adjustments to basis of stock

Under the House bill, when a lower-tier CFC earns subpart F income, and stock in that corporation is later disposed of by an upper-tier CFC, the resulting income inclusion of the U.S. 10-percent shareholders, under regulations, is to be adjusted to account for previous inclusions, in a manner similar to the adjustments provided to the basis of stock in a first-tier CFC. Thus, just as the basis of a U.S. 10-percent shareholder in a first-tier CFC rises when subpart F income is earned and falls when previously taxed income is distributed, so as to avoid double taxation of the income on a later disposition of the stock of that company, the subpart F income from gain on the disposition of a lower-tier CFC generally is reduced by income inclusions of earnings that were not subsequently distributed by the lower-tier CFC.

For example, assume that a U.S. person is the owner of all of the stock of a first-tier CFC which, in turn, is the sole shareholder of a second-tier CFC. In year 1, the second-tier CFC earns $100 of subpart F income which is included in the U.S. person's gross income for that year. In year 2, the first-tier CFC disposes of the second-tier CFC's stock and recognizes $300 of income with respect to the disposition. All of that income constitutes subpart F foreign personal holding company income. Under the House bill, the Secretary is granted regulatory authority to reduce the U.S. person's year 2 subpart F inclusion by $100—the amount of year 1 subpart F income of the second-tier CFC that was included, in that year, in the U.S. person's gross income. Such an adjustment, in effect, allows for a step-up in the basis of the stock of the second-tier CFC to the extent of its subpart F income previously included in the U.S. person's gross income.

Subpart F inclusions in year of acquisition

If a U.S. 10-percent shareholder acquires the stock of a CFC from another U.S. 10-percent shareholder during a taxable year of the CFC in which it earns subpart F income, the House bill provision reduces the acquiror's subpart F income inclusion for that year by a portion of the amount of the dividend deemed (under sec. 1248) to be received by the transferor. The portion by which the inclusion is reduced (as is the case if a dividend was paid to the previous owner of the stock) does not exceed the lesser of the amount of dividends with respect to such stock deemed received (under sec. 1248) by other persons during the year or the amount determined by multiplying the subpart F income for the year by the proportion of the year during which the acquiring shareholder did not own the stock.

Treatment of U.S. income earned by a CFC

Under the House bill, an exemption or reduction by treaty of the branch profits tax that would be imposed under section 884 on a CFC does not affect the general statutory exemption from subpart F income that is granted for U.S. source effectively connected income. For example, assume a CFC earns income of a type that generally would be subpart F income, and that income is earned from sources within the United States in connection with business operations therein. Further assume that repatriation of that income is exempted from the U.S. branch profits tax under a provision of an applicable U.S. income tax treaty. The House bill provides that, notwithstanding the treaty's effect on the branch tax, the income is not treated as subpart F income as long as it is not exempt from U.S. taxation (or subject to a reduced rate of tax) under any other treaty provision.

Extension of indirect foreign tax credit

The House bill extends the application of the indirect foreign tax credit (secs. 902 and 960) to taxes paid or accrued by certain fourth-, fifth-, and sixth-tier foreign corporations. In general, three requirements are required to be satisfied by a foreign company at any of these tiers to qualify for the credit. First, the company must be a CFC. Second, the U.S. corporation claiming the credit under section 902(a) must be a U.S. shareholder (as defined in sec. 951(b)) with respect to the foreign company. Third, the product of the percentage ownership of voting stock at each level from the U.S. corporation down must equal at least 5 percent. The House bill limits the application of the indirect foreign tax credit below the third tier to taxes paid or incurred in taxable years during which the payor is a CFC. Foreign taxes paid below the sixth tier of foreign corporations remain ineligible for the indirect foreign tax credit.

Effective dates

Lower-tier CFCs.—The provision that treats gains on dispositions of stock in lower-tier CFCs as dividends under section 1248 principles applies to gains recognized on transactions occurring after the date of enactment.

The provision that expands look-through treatment, for foreign tax credit limitation purposes, of dividends from CFCs is effective for distributions after the date of enactment.

The provision that provides for regulatory adjustments to U.S. shareholder inclusions, with respect to gains of CFCs from dispositions of stock in lower-tier CFCs is effective for determining inclusions for taxable years of U.S. shareholders beginning after December 31, 1997. Thus, the House bill permits regulatory adjustments to an inclusion occurring after the effective date to account for income that was previously taxed under the subpart F provisions either prior to or subsequent to the effective date.

Subpart F inclusions in year of acquisition.—The provision that permits dispositions of stock to be taken into consideration in determining a U.S. shareholder's subpart F inclusion for a taxable year is effective with respect to dispositions occurring after the date of enactment.

Treatment of U.S. source income earned by a CFC.—The provision concerning the effect of treaty exemptions from, or reductions of, the branch profits tax on the determination of subpart F income is effective for taxable years beginning after December 31, 1986.

Extension of indirect foreign tax credit.—The provision that extends application of the indirect foreign tax credit to certain CFCs below the third tier is effective for foreign taxes paid or incurred by CFCs for taxable years of such corporations beginning after the date of enactment.

In the case of any chain of foreign corporations, the taxes of which would be eligible for the indirect foreign tax credit, under present law or under the House bill, but for the denial of indirect credits below the third or sixth tier, as the case may be, no liquidation, reorganization, or similar transaction in a taxable year beginning after the date of enactment will have the effect of permitting taxes to be taken into account under the indirect foreign tax credit provisions of the Code which could not have been taken into account under those provisions but for such transaction.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Modification of Passive Foreign Investment Company Provisions to Eliminate Overlap with Subpart F, to Allow Mark-to-Market Election, and to Require Measurement Based on Value for PFIC Asset Test (secs. 1121–1123 of the House bill and secs. 751–753 of the Senate amendment)

Present Law

Overview

U.S. citizens and residents and U.S. corporations (collectively, "U.S. persons") are taxed currently by the United States on their worldwide income, subject to a credit against U.S. tax on foreign income based on foreign income taxes paid with respect to such income. A foreign corporation generally is not subject to U.S. tax on its income from operations outside the United States.

Income of a foreign corporation generally is taxed by the United States when it is repatriated to the United States through payment to the corporation's U.S. shareholders, subject to a foreign tax credit. However, a variety of regimes imposing current U.S. tax on income earned through a foreign corporation have been reflected in the Code. Today the principal anti-deferral regimes set forth in the Code are the controlled foreign corporation rules of subpart F (secs. 951–964) and the passive foreign investment company rules (secs. 1291–1297). Additional anti-deferral regimes set forth in the Code are the foreign personal holding company rules (secs. 551–558); the personal holding company rules (secs. 541–547); the accumulated earnings tax (secs. 531–537); and the foreign investment company and electing foreign investment company rules (secs. 1246–1247). The anti-deferral regimes included in the Code overlap such that a given taxpayer may be subject to multiple sets of anti-deferral rules.

Controlled foreign corporations

A controlled foreign corporation (CFC) is defined generally as any foreign corporation if U.S. persons own more than 50 percent of the corporation's stock (measured by vote or value), taking into account only those U.S. persons that own at least 10 percent of the stock (measured by vote only) (sec. 957). Stock ownership includes not only stock owned directly, but also stock owned indirectly or constructively (sec. 958).

Certain income of a CFC (referred to as "subpart F income") is subject to current U.S. tax. The United States generally taxes the U.S. 10-percent shareholders of a CFC currently on their pro rata shares of the subpart F income of the CFC. In effect, the Code treats those U.S. shareholders as having received a current distribution out of the CFC's subpart F income. Such shareholders also are subject to current U.S. tax on their pro rata shares of the CFC's earnings invested in U.S. property. The foreign tax credit may reduce the U.S. tax on these amounts.

Passive foreign investment companies

The Tax Reform Act of 1986 established an anti-deferral regime for passive foreign investment companies (PFICs). A PFIC is any foreign corporation if (1) 75 percent or more of its gross income for the taxable year consists of passive income, or (2) 50 percent or more of the average fair market value of its assets consists of assets that produce, or are held for the production of, passive income. For purposes of applying the PFIC asset test, the assets of a CFC are required to be measured using adjusted basis; the assets of a foreign corporation that is not a CFC are measured using fair market value unless the corporation elects to use adjusted basis.

Two alternative sets of income inclusion rules apply to U.S. persons that are shareholders in a PFIC. One set of rules applies to PFICs that are "qualified electing funds," under which electing U.S. shareholders include currently in gross income their respective shares of the PFIC's total earnings, with a separate election to defer payment of tax, subject to an interest charge, on income not currently received. The second set of rules applies to PFICs that are not qualified electing funds ("nonqualified funds"), under which the U.S. shareholders pay tax on income realized from the PFIC and an interest charge that is attributable to the value of deferral.

Overlap between subpart F and the PFIC provisions

A foreign corporation that is a CFC is also a PFIC if it meets the passive income test or the passive asset test described above. In such a case, the 10-percent U.S. shareholders are subject both to the subpart F provisions (which require current inclusion of certain earnings of the corporation) and to the PFIC provisions (which impose an interest charge on amounts distributed from the corporation and gains recognized upon the disposition of the corporation's stock, unless an election is made to include currently all of the corporation's earnings).

House Bill

Elimination of overlap between subpart F and the PFIC provisions

In the case of a PFIC that is also a CFC, the House bill generally treats the corporation as not a PFIC with respect to certain 10-percent shareholders. This rule applies if the corporation is a CFC (within the meaning of section 957(a)) and the shareholder is a U.S. shareholder (within the meaning of section 951(b)) of such corporation (i.e., if the shareholder is subject to the current inclusion rules of subpart F with respect to such corporation). Moreover, the rule applies for that portion of the shareholder's holding period with respect to the corporation's stock which is after December 31, 1997 and during which the corporation is a CFC and the shareholder is a U.S. shareholder. Accordingly, a shareholder that is subject to current inclusion under the subpart F rules with respect to stock of a PFIC that is also a CFC generally is not subject also to the PFIC provisions with respect to the same stock. The PFIC provisions continue to apply in the case of a PFIC that is also a CFC to shareholders that are not subject to subpart F (i.e., to shareholders that are U.S. persons and that own (directly, indirectly, or constructively) less than 10 percent of the corporation's stock by vote).

If a shareholder of a PFIC is subject to the rules applicable to nonqualified funds before becoming eligible for the special rules provided under the proposal for shareholders that are subject to subpart F, the stock held by such shareholder continues to be treated as PFIC stock unless the shareholder makes an election to pay tax and an interest charge with respect to the unrealized appreciation in the stock or the accumulated earnings of the corporation.

If, under the House bill, a shareholder is not subject to the PFIC provisions because the shareholder is subject to subpart F and the shareholder subsequently ceases to be subject to subpart F with respect to the corporation, for purposes of the PFIC provisions, the shareholder's holding period for such stock is treated as beginning immediately after such cessation. Accordingly, in applying the rules applicable to PFICs that are not qualified electing funds, the earnings of the corporation are not attributed to the period during which the shareholder was subject to subpart F with respect to the corporation and was not subject to the PFIC provisions.

Mark-to-market election

The House bill allows a shareholder of a PFIC to make a mark-to-market election with respect to the stock of the PFIC, provided that such stock is marketable (as defined below). Under such an election, the shareholder includes in income each year an amount equal to the excess, if any, of the fair market value of the PFIC stock as of the close of the taxable year over the shareholder's adjusted basis in such stock. The shareholder is allowed a deduction for the excess, if any, of the adjusted basis of the PFIC stock over its fair market value as of the close of the taxable year. However, deductions are allowable under this rule only to the extent of any net mark-to-market gains with respect to the stock included by the shareholder for prior taxable years.

Under the House bill, this mark-to-market election is available only for PFIC stock that is "marketable." For this purpose, PFIC stock is considered marketable if it is regularly traded on a national securities exchange that is registered with the Securities and Exchange Commission or on the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934. In addition, PFIC stock is considered marketable if it is regularly traded on any exchange or market that the Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a legitimate and sound fair market value. Any option on stock that is considered marketable under the foregoing rules is treated as marketable, to the extent provided in regulations. PFIC stock also is treated as marketable, to the extent provided in regulations, if the PFIC offers for sale (or has outstanding) stock of which it is the issuer and which is redeemable at its net asset value in a manner comparable to a U.S. regulated investment company (RIC).

In addition, the House bill treats as marketable any PFIC stock owned by a RIC that offers for sale (or has outstanding) any stock of which it is the issuer and which is redeemable at its net asset value. The House bill treats as marketable any PFIC stock held by any other RIC that otherwise publishes net asset valuations at least annually, except to the extent provided in regulations. It is believed that even for RICs that do not make a market in their own stock, but that do regularly report their net asset values in compliance with the securities laws, inaccurate valuation may bring exposure to legal liabilities, and this exposure may ensure the reliability of the values such RICs assign to the PFIC stock they hold.

The shareholder's adjusted basis in the PFIC stock is adjusted to reflect the amounts included or deducted under this election. In the case of stock owned indirectly by a U.S. person through a foreign entity (as discussed below), the basis adjustments for mark-to-market gains and losses apply to the basis of the PFIC in the hands of the intermediary owner, but only for purposes of the subsequent application of the PFIC rules to the tax treatment of the indirect U.S. owner. In addition, similar basis adjustments are made to the adjusted basis of the property actually held by the U.S. person by reason of which the U.S. person is treated as owning PFIC stock.

Amounts included in income pursuant to a mark-to-market election, as well as gain on the actual sale or other disposition of the PFIC stock, is treated as ordinary income. Ordinary loss treatment also applies to the deductible portion of any mark-to-market loss on PFIC stock, as well as to any loss realized on the actual sale or other disposition of PFIC stock to the extent that the amount of such loss does not exceed the net mark-to-market gains previously included with respect to such stock. The source of amounts with respect to a mark-to-market election generally is determined in the same manner as if such amounts were gain or loss from the sale of stock in the PFIC.

An election to mark to market applies to the taxable year for which made and all subsequent taxable years, unless the PFIC stock ceases to be marketable or the Secretary of the Treasury consents to the revocation of such election.

Under constructive ownership rules, U.S. persons that own PFIC stock through certain foreign entities may make this election with respect to the PFIC. These constructive ownership rules apply to treat PFIC stock owned directly or indirectly by or for a foreign partnership, trust, or estate as owned proportionately by the partners or beneficiaries, except as provided in regulations. Stock in a PFIC that is thus treated as owned by a person is treated as actually owned by that person for purposes of again applying the constructive ownership rules. In the case of a U.S. person that is treated as owning PFIC stock by application of this constructive ownership rule, any disposition by the U.S. person or by any other person that results in the U.S. person being treated as no longer owning the PFIC stock, as well as any disposition by the person actually owning the PFIC stock, is treated as a disposition by the U.S. person of the PFIC stock.

In addition, a CFC that owns stock in a PFIC is treated as a U.S. person that may make the election with respect to such PFIC stock. Any amount includible (or deductible) in the CFC's gross income pursuant to this mark-to-market election is treated as foreign personal holding company income (or a deduction allocable to foreign personal holding company income). The source of such amounts, however, is determined by reference to the actual residence of the CFC.

In the case of a taxpayer that makes the mark-to-market election with respect to stock in a PFIC that is a nonqualified fund after the beginning of the taxpayer's holding period with respect to such stock, a coordination rule applies to ensure that the taxpayer does not avoid the interest charge with respect to amounts attributable to periods before such election. A similar rule applies to RICs that make the mark-to-market election under the House bill after the beginning of their holding period with respect to PFIC stock (to the extent that the RIC had not previously marked to market the stock of the PFIC).

Except as provided in the coordination rules described above, the rules of section 1291 (with respect to nonqualified funds) do not apply to a shareholder of a PFIC if a mark-to-market election is in effect for the shareholder's taxable year. Moreover, in applying section 1291 in a case where a mark-to-market election was in effect for any prior taxable year, the shareholder's holding period for the PFIC stock is treated as beginning immediately after the last taxable year for which such election applied.

A special rule applicable in the case of a PFIC shareholder that becomes a U.S. person treats the adjusted basis of any PFIC stock held by such person on the first day of the year in which such shareholder becomes a U.S. person as equal to the greater of its fair market value on such date or its adjusted basis on such date. Such rule applies only for purposes of the mark-to-market election.

Effective date

The provision is effective for taxable years of U.S. persons beginning after December 31, 1997, and taxable years of foreign corporations ending with or within such taxable years of U.S. persons.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with one modification to the rules regarding the measurement of assets for purposes of applying the PFIC asset test. Under the conference agreement, if the stock of a foreign corporation is publicly traded for the taxable year, the PFIC asset test is applied using fair market value for purposes of measuring the PFIC's assets. For this purpose, the stock of a foreign corporation is treated as publicly traded if such stock is readily tradeable on a national securities exchange that is registered with the Securities and Exchange Commission, the national market system established pursuant to section 11A of the Securities and Exchange Act of 1934, or any other exchange or market that the Secretary of the Treasury determines has rules sufficient to ensure that the market price represents a sound fair market value. Because the PFIC asset test is applied based on quarterly measurements of the corporation's assets, it is intended that a corporation the stock of which is publicly traded on each such quarterly measurement date during the taxable year will be eligible for this asset measurement rule for such taxable year. In applying the PFIC asset test, it is intended that the total value of a publicly-traded foreign corporation's assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities.

The conference agreement does not change the rules applicable to non-publicly-traded foreign corporations for purposes of the measurement of assets in applying the PFIC asset test. Accordingly, CFCs that are not publicly traded continue to be required to measure their assets using adjusted basis, and any other foreign corporations that are not publicly traded continue to measure their assets using fair market value unless they elect to use adjusted basis.

D. Simplify Formation and Operation of International Joint Ventures (secs. 1131, 1141–1145, and 1151 of the House bill and secs. 921, 931–935, and 941 of the Senate amendment)

Present Law

Under section 1491, an excise tax generally is imposed on transfers of property by a U.S. person to a foreign corporation as paid-in surplus or as a contribution to capital or to a foreign partnership, estate or trust. The tax is 35 percent of the amount of gain inherent in the property transferred but not recognized for income tax purposes at the time of the transfer. However, several exceptions to the section 1491 excise tax are available. Under section 1494(c), a substantial penalty applies in the case of a failure to report a transfer described in section 1491.

Section 367 applies to require gain recognition upon certain transfers by U.S. persons to foreign corporations. Under section 367(d), a U.S. person that contributes intangible property to a foreign corporation is treated as having sold the property to the corporation and is treated as receiving deemed royalty payments from the corporation. These deemed royalty payments are treated as U.S. source income. A U.S. person may elect to apply similar rules to a transfer of intangible property to a foreign partnership that otherwise would be subject to the section 1491 excise tax.

A foreign partnership may be required to file a partnership return. If a foreign partnership fails to file a required return, losses and credits with respect to the partnership may be disallowed to the partnership. A U.S. person that acquires or disposes of an interest in a foreign partnership, or whose proportional interest in the partnership changes substantially, may be required to file an information return with respect to such event.

A partnership generally is considered to be a domestic partnership if it is created or organized in the United States or under the laws of the United States or any State. A foreign partnership generally is any partnership that is not a domestic partnership.

House Bill

Transfers of foreign entities

The House bill repeals the sections 1491–1494 excise tax and information reporting rules that apply to certain transfers of appreciated property by a U.S. person to a foreign entity. Instead of the excise tax that applies under present law to transfers to a foreign estate or trust, gain recognition is required upon a transfer of appreciated property by a U.S. person to a foreign estate or trust. Instead of the excise tax that applies under present law to certain transfers to foreign corporations, regulatory authority is granted under section 367 to deny nonrecognition treatment to such a transfer in a transaction that is not otherwise described in section 367. Instead of the excise tax that applies under present law to transfers to foreign partnerships, regulatory authority is granted to provide for gain recognition on a transfer of appreciated property to a partnership in cases where such gain otherwise would be transferred to a foreign partner. In addition, regulatory authority is granted to deny the nonrecognition treatment that is provided under section 1035 to certain exchanges of insurance policies, where the transfer is to a foreign person.

The House bill repeals the rule that treats as U.S. source income any deemed royalty arising under section 367(d). Under the House bill, in the case of a transfer of intangible property to a foreign corporation, the deemed royalty payments under section 367(d) are treated as foreign source income to the same extent that an actual royalty payment would be considered to be foreign source income. Regulatory authority is granted to provide similar treatment in the case of a transfer of intangible property to a foreign partnership.

Information reporting

The House bill provides detailed information reporting rules in the case of foreign partnerships. A foreign partnership generally is required to file a partnership return for a taxable year if the partnership has U.S. source income or is engaged in a U.S. trade or business, except to the extent provided in regulations.

Under the House bill, reporting rules similar to those applicable under present law in the case of controlled foreign corporations apply in the case of foreign partnerships. A U.S. partner that controls a foreign partnership is required to file an annual information return with respect to such partnership. For this purpose, a U.S. partner is considered to control a foreign partnership if the partner holds a more than 50 percent interest in the capital, profits, or, to the extent provided in regulations, losses, of the partnership. Similar information reporting also will be required from a U.S. 10-percent partner of a foreign partnership that is controlled by U.S. 10-percent partners. A $10,000 penalty applies to a failure to comply with these reporting requirements; additional penalties of up to $50,000 apply in the case of continued noncompliance after notification by the Secretary of the Treasury. The penalties for failure to report information with respect to a controlled foreign corporation are conformed with these penalties.

Under the House bill, reporting by a U.S. person of an acquisition or disposition of an interest in a foreign partnership, or a change in the person's proportional interest in the partnership, is required only in the case of acquisitions, dispositions, or changes involving at least a 10-percent interest. A $10,000 penalty applies to a failure to comply with these reporting requirements; additional penalties of up to $50,000 apply in the case of continued noncompliance after notification by the Secretary. The penalties for failure to report information with respect to a foreign corporation are conformed with these penalties.

Under the House bill, reporting rules similar to those applicable under present law in the case of transfers by U.S. persons to foreign corporations apply in the case of transfers to foreign partnerships. These reporting rules apply in the case of a transfer to a foreign partnership only if the U.S. person holds at least a 10-percent interest in the partnership or the value of the property transferred by such person to the partnership during a 12-month period exceeded $100,000. A penalty equal to 10 percent of the value of the property transferred applies to a failure to comply with these reporting requirements. The penalty under present law for failure to report transfers to a foreign corporation is conformed with this penalty. In the case of a transfer to a foreign partnership, failure to comply also results in gain recognition with respect to the property transferred.

Under the House bill, in the case of a failure to report required information with respect to a foreign corporation, partnership, or trust, the statute of limitations with respect to any event or period to which such information relates does not expire before the date that is three years after the date on which such information is provided.

Foreign or domestic partnership determination

Under the House bill, regulatory authority is granted to provide rules treating a partnership as a foreign partnership where such treatment is more appropriate. It is expected that a recharacterization of a partnership as foreign rather than domestic under such regulations will be based only on material factors such as the residence of the partners and the extent to which the partnership is engaged in business in the United States or earns U.S. source income. It also is expected that such regulations will provide guidance regarding the determination of whether an entity that is a partnership for Federal income tax purposes is to be considered to be created or organized in the United States or under the law of the United States or any State.

Effective date

The provisions with respect to the repeal of sections 1491–1494 are effective upon date of enactment. The provisions with respect to the source of a deemed royalty under section 367(d) also are effective for transfers made and royalties deemed received after date of enactment.

The provisions regarding information reporting with respect to foreign partnerships generally are effective for partnership taxable years beginning after date of enactment. The provisions regarding information reporting with respect to interests in, and transfers to, foreign partnerships are effective for transfers to, and changes in interest in, foreign partnerships after date of enactment. Taxpayers may elect to apply these rules to transfers made after August 20, 1996 (and thereby avoid a penalty under section 1494(c)) and the Secretary may prescribe simplified reporting requirements for these cases. The provision with respect to the statute of limitations in the case of noncompliance with reporting requirements is effective for information returns due after date of enactment.

The provision granting regulatory authority with respect to the treatment of partnerships as foreign or domestic is effective for partnership taxable years beginning after date of enactment.

Senate Amendment

The Senate amendment generally follows the House bill with several modifications.

Under the Senate amendment, gain recognition is required upon a transfer of appreciated property by a U.S. person to a foreign estate or trust, except as provided in regulations. This rule does not apply to a transfer to a trust to the extent that any person is treated as the owner of the trust under section 679.

Under the Senate amendment, the penalty equal to 10 percent of the value of the transferred property that applies to a failure to comply with the information reporting requirements with respect to a transfer of property to a foreign corporation or partnership may not exceed $100,000 except in cases of intentional disregard for such reporting requirements.

Under the Senate amendment, regulatory authority is granted to provide rules treating a partnership as a domestic or foreign partnership, where such treatment is more appropriate, without regard to where the partnership is created or organized. It is expected that a recharacterization of a partnership under such regulations will be based only on material factors such as the residence of the partners and the extent to which the partnership is engaged in business in the United States or earns U.S. source income. It also is expected that such regulations will provide guidance regarding the determination of whether an entity that is a partnership for Federal income tax purposes is to be considered to be created or organized in the United States or under the law of the United States or any State.

Conference Agreement

The conference agreement generally follows the Senate amendment with modifications.

The conference agreement clarifies that, for purposes of the requirement of gain recognition upon a transfer of appreciated property by a U.S. person to a foreign estate or trust, a U.S. trust that becomes a foreign trust is treated as having transferred all of its assets to a foreign trust.

The conference agreement further clarifies that, in the case of a transfer by a U.S. person to a foreign corporation as paid-in surplus or as a contribution to capital in a transaction not otherwise described in section 367 (e.g., a capital contribution by a non-shareholder), regulatory authority is granted under section 367 to treat such transfer as a fair market value sale and to require gain recognition thereon.

For purposes of the information reporting rules applicable to a U.S. partner that controls a foreign partnership, the conference agreement clarifies that a partner's interest in a partnership is determined with application of constructive ownership rules similar to those provided in section 267(c) (other than paragraph (3)).

Finally, the conference agreement provides that regulations issued under the grant of regulatory authority to provide rules treating a partnership as a domestic or foreign partnership will apply only to partnerships created or organized after the date such regulations are filed with the Federal Register (or, if earlier, the date of a public notice substantially describing the expected contents of the regulations). Accordingly, regulations issued under this grant of regulatory authority will not be applied to reclassify pre-existing partnerships. In connection with this regulatory authority, the conferees wish to make clear that it is intended that the general rule for classifying a partnership as domestic or foreign will continue to be the place where the partnership is created or organized (or the laws under which it is created or organized), and that the regulations are expected to provide a different classification result only in unusual cases. The conferees also expect that any regulations will avoid period-by-period reclassifications of partnerships.

E. Modification of Reporting Threshold for Stock Ownership of a Foreign Corporation (sec. 1146 of the House bill and sec. 936 of the Senate amendment)

Present Law

Several provisions of the Code require U.S. persons to report information with respect to a foreign corporation in which they are shareholders or officers or directors. Sections 6038 and 6035 generally require every U.S. citizen or resident who is an officer, or director, or who owns at least 10 percent of the stock, of a foreign corporation that is a controlled foreign corporation or a foreign personal holding company to file Form 5471 annually.

Section 6046 mandates the filing of information returns by certain U.S. persons with respect to a foreign corporation upon the occurrence of certain events. U.S. persons required to file these information returns are those who acquire 5 percent or more of the value of the stock of a foreign corporation, others who become U.S. persons while owning that percentage of the stock of a foreign corporation, and U.S. citizens and residents who are officers or directors of foreign corporations with such U.S. ownership.

A failure to file the required information return under section 6038 may result in monetary penalties or reduction of foreign tax credit benefits. A failure to file the required information returns under sections 6035 or 6046 may result in monetary penalties.

House Bill

The House bill increases the threshold for stock ownership of a foreign corporation that results in information reporting obligations under section 6046 from 5 percent (based on value) to 10 percent (based on vote or value).

Effective date.—The provision is effective for reportable transactions occurring after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

F. Other Foreign Simplification Provisions

1. Transition rule for certain trusts (sec. 1161 of the House bill and sec. 951 of the Senate amendment)

Present Law

Under rules enacted with the Small Business Job Protection Act of 1996, a trust is considered to be a U.S. trust if two criteria are met. First, a court within the United States must be able to exercise primary supervision over the administration of the trust. Second, U.S. fiduciaries of the trust must have the authority to control all substantial decisions of the trust. A trust that does not satisfy both of these criteria is considered to be a foreign trust. These rules for defining a U.S. trust generally are effective for taxable years of a trust that begin after December 31, 1996. A trust that qualified as a U.S. trust under prior law could fail to qualify as a U.S. trust under these new criteria.

House Bill

Under the House bill, the Secretary of the Treasury is granted authority to allow nongrantor trusts that had been treated as U.S. trusts under prior law to elect to continue to be treated as U.S. trusts, notwithstanding the new criteria for qualification as a U.S. trust.

Effective date.—The provision is effective for taxable years beginning after December 31, 1996.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Simplify stock and securities trading safe harbor (sec. 1162 of the House bill and sec. 952 of the Senate amendment)

Present Law

A nonresident alien individual or foreign corporation that is engaged in a trade or business within the United States is subject to U.S. taxation on its net income that is effectively connected with the trade or business, at graduated rates of tax. Under a "safe harbor" rule, foreign persons that trade in stocks or securities for their own accounts are not treated as engaged in a U.S. trade or business for this purpose.

For a foreign corporation to qualify for the safe harbor, it must not be a dealer in stock or securities. In addition, if the principal business of the foreign corporation is trading in stock or securities for its own account, the safe harbor generally does not apply if the principal office of the corporation is in the United States.

For foreign persons who invest in securities trading partnerships, the safe harbor applies only if the partnership is not a dealer in stock and securities. In addition, if the principal business of the partnership is trading stock or securities for its own account, the safe harbor generally does not apply if the principal office of the partnership is in the United States.

Under Treasury regulations that apply to both corporations and partnerships, the determination of the location of the entity's principal office turns on the location of various functions relating to operation of the entity, including communication with investors and the general public, solicitation and acceptance of sales of interests, and maintenance and audits of its books of account (Treas. reg. sec. 1.864–2(c)(2) (ii) and (iii)). Under the regulations, the location of the entity's principal office does not depend on the location of the entity's management or where investment decisions are made.

House Bill

The House bill modifies the stock and securities trading safe harbor by eliminating the requirement for both partnerships and foreign corporations that trade stock or securities for their own accounts that the entity's principal office not be within the United States.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Clarification of determination of foreign taxes deemed paid (sec. 1178(a) of the House bill and sec. 953(a) of the Senate amendment)

Present Law

Under section 902, a domestic corporation that receives a dividend from a foreign corporation in which it owns 10 percent or more of the voting stock is deemed to have paid a portion of the foreign taxes paid by such foreign corporation. The domestic corporation that receives a dividend is deemed to have paid a portion of the foreign corporation's post-1986 foreign income taxes based on the ratio of the amount of such dividend to the foreign corporation's post-1986 undistributed earnings. The foreign corporation's post-

1986 foreign income taxes is the sum of the foreign income taxes with respect to the taxable year in which the dividend is distributed plus certain foreign income taxes with respect to prior taxable years (beginning after December 31, 1986).

House Bill

The House bill clarifies that, for purposes of the deemed paid credit under section 902 for a taxable year, a foreign corporation's post-1986 foreign income taxes includes foreign income taxes with respect to prior taxable years (beginning after December 31, 1986) only to the extent such taxes are not attributable to dividends distributed by the foreign corporation in prior taxable years. No inference is intended regarding the determination of foreign taxes deemed paid under present law.

Effective date.—The provision is effective on date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Clarification of foreign tax credit limitation for financial services income (sec. 1178(b) of the House bill and sec. 953(b) of the Senate amendment)

Present Law

Under section 904, separate foreign tax credit limitations apply to various categories of income. Two of these separate limitation categories are passive income and financial services income. For purposes of the separate foreign tax credit limitation applicable to passive income, certain income that is treated as high-taxed income is excluded from the definition of passive income. For purposes of the separate foreign tax credit limitation applicable to financial services income, the definition of financial services income generally incorporates passive income as defined for purposes of the separate limitation applicable to passive income.

House Bill

The House bill clarifies that the exclusion of income that is treated as high-taxed income does not apply for purposes of the separate foreign tax credit limitation applicable to financial services income. No inference is intended regarding the treatment of high-taxed income for purposes of the separate foreign tax credit limitation applicable to financial services income under present law.

Effective date.—The provision is effective on date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

G. Other Foreign Provisions

1. Eligibility of licenses of computer software for foreign sales corporation benefits (sec. 1101 of the House bill and sec. 741 of the Senate amendment)

Present Law

Under special tax provisions that provide an export benefit, a portion of the foreign trade income of an eligible foreign sales corporation ("FSC") is exempt from Federal income tax. Foreign trade income is defined as the gross income of a FSC that is attributable to foreign trading gross receipts. The term "foreign trading gross receipts" includes the gross receipts of a FSC from the sale, lease, or rental of export property and from services related and subsidiary to such sales, leases, or rentals.

For purposes of the FSC rules, export property is defined as property (1) which is manufactured, produced, grown, or extracted in the United States by a person other than a FSC; (2) which is held primarily for sale, lease, or rental in the ordinary conduct of a trade or business by or to a FSC for direct use, consumption, or disposition outside the United States; and (3) not more than 50 percent of the fair market value of which is attributable to articles imported into the United States. Intangible property generally is excluded from the definition of export property for purposes of the FSC rules; this exclusion applies to copyrights other than films, tapes, records, or similar reproductions for commercial or home use. The temporary Treasury regulations provide that a license of a master recording tape for reproduction outside the United States is not excluded from the definition of export property (Treas. Reg. sec. 1.927(a)–1T(f)(3)). The statutory exclusion for intangible property does not contain any specific reference to computer software. However, the temporary Treasury regulations provide that a copyright on computer software does not constitute export property, and that standardized, mass marketed computer software constitutes export property if such software is not accompanied by a right to reproduce for external use (Treas. Reg. sec. 1.927(a)–1T(f)(3)).

House Bill

The House bill provides that computer software licensed for reproduction abroad is not excluded from the definition of export property for purposes of the FSC provisions. Accordingly, computer software that is exported with a right to reproduce is eligible for the benefits of the FSC provisions. In light of the rapid innovations in the computer and software industries, the Committee intends that the term "computer software" be construed broadly to accommodate technological changes in the products produced by both industries. No inference is intended regarding the qualification as export property of computer software licensed for reproduction abroad under present law.

Effective date.—The provision generally applies to gross receipts from computer software licenses attributable to periods after December 31, 1997. Accordingly, in the case of a multi-year license, the provision applies to gross receipts attributable to the period of such license that is after December 31, 1997. In the case of gross receipts attributable to 1998, the provision applies to only one-third of such gross receipts. In the case of gross receipts attributable to 1999, the provision applies to only two-thirds of such gross receipts.

Senate Amendment

The Senate amendment is the same as the House bill, with a modification to the effective date.

Effective date.—The provision applies to gross receipts from computer software licenses attributable to periods after December 31, 1997. Accordingly, in the case of a multi-year license, the provision applies to gross receipts attributable to the period of such license that is after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Increase dollar limitation on section 911 exclusion (sec. 1102 of the House bill)

Present Law

U.S. citizens generally are subject to U.S. income tax on all their income, whether derived in the United States or elsewhere. A U.S. citizen who earns income in a foreign country also may be taxed on such income by that foreign country. A credit against the U.S. income tax imposed on foreign source income is allowed for foreign taxes paid on such income.

U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either (1) a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year or (2) present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

The exclusion for foreign earned income generally applies to income earned from sources outside the United States as compensation for personal services actually rendered by the taxpayer. The maximum exclusion for foreign earned income for a taxable year is $70,000.

The exclusion for housing costs applies to reasonable expenses, other than deductible interest and taxes, paid or incurred by or on behalf of the taxpayer for housing for the taxpayer and his or her spouse and dependents in a foreign country. The exclusion amount for housing costs for a taxable year is equal to the excess of such housing costs for the taxable year over an amount computed pursuant to a specified formula.

The combined earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income.

The taxpayer's foreign tax credit is reduced by the amount of the credit that is attributable to excluded income.

House Bill

Under the House bill, the $70,000 limitation on the exclusion for foreign earned income is increased to $80,000, in increments of $2,000 each year beginning in 1998. The $80,000 limitation on the exclusion for foreign earned income is indexed for inflation beginning in 2008 (for inflation after 2006).

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Treatment of certain securities positions under the subpart F investment in U.S. property rules (sec. 743 of the Senate amendment)

Present Law

Under the rules of subpart F (secs. 951–964), the U.S. 10-percent shareholders of a controlled foreign corporation (CFC) are required to include in income currently for U.S. tax purposes certain earnings of the CFC, whether or not such earnings are distributed currently to the shareholders. The U.S. 10-percent shareholders of a CFC are subject to current U.S. tax on their shares of certain income earned by the CFC (referred to as "subpart F income'). The U.S. 10-percent shareholders also are subject to current U.S. tax on their shares of the CFC's earnings to the extent invested by the CFC in certain U.S. property.

A shareholder's current income inclusion with respect to a CFC's investment in U.S. property for a taxable year is based on the CFC's average investment in U.S. property for such year. For this purpose, the U.S. property held by the CFC must be measured as of the close of each quarter in the taxable year. U.S. property generally is defined to include tangible property located in the United States, stock of a U.S. corporation, obligations of a U.S. person, and the right to use certain intellectual property in the United States. Exceptions are provided for, among other things, obligations of the United States, U.S. bank deposits, certain trade or business obligations, and stock or debts of certain unrelated U.S. corporations.

House Bill

No provision.

Senate Amendment

The Senate amendment provides two additional exceptions from the definition of U.S. property for purposes of the subpart F rules. Both exceptions relate to transactions entered into by a securities or commodities dealer in the ordinary course of its business as a securities or commodities dealer.

The first exception covers the deposit of collateral or margin by a securities or commodities dealer, or the receipt of such a deposit by a securities or commodities dealer, if such deposit is made or received on commercial terms in the ordinary course of the dealer's business as a securities or commodities dealer. This exception applies to deposits of margin or collateral for securities loans, notional principal contracts, options contracts, forward contracts, futures contracts, and any other financial transaction with respect to which the Secretary of the Treasury determines that the posting of collateral or margin is customary.

The second exception covers repurchase agreement transactions and reverse repurchase agreement transactions entered into by or with a securities or commodities dealer in the ordinary course of its business as a securities or commodities dealer. The exception applies only to the extent that the obligation under the transaction does not exceed the fair market value of readily marketable securities transferred or otherwise posted as collateral.

Effective date.—The provision is effective for taxable years of foreign corporations beginning after December 31, 1997, and taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Conference Agreement

The conference agreement generally follows the Senate amendment. Under the conference agreement, for purposes of these two additional exceptions under section 956, the term "dealer in commodities" means futures commission merchants and dealers in commodities within the meaning of the new definition that is added to section 475 by the conference agreement. In addition, the conferees wish to clarify that the addition of these two exceptions under section 956 is not intended to create any inference regarding the treatment of an obligation of a U.S. person to return stock that is borrowed pursuant to a securities loan.

4. Exception from foreign personal holding company income under subpart F for active financing income (sec. 744 of the Senate amendment)

Present Law

Under the subpart F rules, certain U.S. shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. The U.S. 10-percent shareholders of a CFC also are subject to current inclusion with respect to their shares of the CFC's foreign base company services income (i.e., income derived from services performed for a related person outside the country in which the CFC is organized).

Foreign personal holding company income generally consists of the following: dividends, interest, royalties, rents and annuities; net gains from sales or exchanges of (1) property that gives rise to the preceding types of income, (2) property that does not give rise to income, and (3) interests in trusts, partnerships, and REMICs; net gains from commodities transactions; net gains from foreign currency transactions; and income that is equivalent to interest.

Insurance income subject to current inclusion under the subpart F rules includes any income of a CFC attributable to the issuing or reinsuring of any insurance or annuity contract in connection with risks located in a country other than the CFC's country of organization and related person insurance income. Subpart F insurance income also includes income attributable to an insurance contract in connection with risks located within the CFC's country of organization, as the result of an arrangement under which another corporation receives a substantially equal amount of consideration for insurance of other-country risks. Investment income of a CFC that is allocable to any insurance or annuity contract related to risks located outside the CFC's country of organization is taxable as subpart F insurance income (Prop. Treas. reg. sec. 1.953–1(a)). Investment income allocable to risks located within the CFC's country of organization generally is taxable as foreign personal holding company income.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a temporary exception from foreign personal holding company income for subpart F purposes for certain income that is derived in the active conduct of an insurance, banking, financing or similar business. Such exception is applicable only for taxable years beginning in 1998.

Under the Senate amendment, foreign personal holding company income does not include income that is derived in or incident to the active conduct of a banking, financing or similar business by a CFC that is predominantly engaged in the active conduct of such business. For this purpose, income derived in the active conduct of a banking, financing, or similar business generally is determined under the principles applicable in determining financial services income for foreign tax credit limitation purposes. Moreover, the Secretary of the Treasury shall prescribe regulations applying look-through treatment in characterizing for this purpose dividends, interest, income equivalent to interest, rents, and royalties from related persons. A CFC is considered to be predominantly engaged in the active conduct of a banking, financing, or similar business if (1) more than 70 percent of its gross income is derived from transactions with unrelated persons and more than 20 percent of its gross income from that business is derived from transactions with unrelated persons located within the country in which the CFC is organized or incorporated, or (2) the CFC is predominantly engaged in the active conduct of a banking or securities business, or is a qualified bank or securities affiliate, as defined for purposes of the passive foreign investment company provisions.

Under the Senate amendment, foreign personal holding company income also does not include certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of organization. These exceptions apply to income derived from investments of assets equal to the total of (1) unearned premiums and reserves ordinary and necessary for the proper conduct of the CFC's insurance business, (2) one-third of premiums earned during the taxable year on insurance contracts regulated in the country in which sold as property, casualty, or health insurance contracts, and (3) the greater of $10 million or 10 percent of reserves for insurance contracts regulated in the country in which sold as life insurance or annuity contracts. For this purpose, a qualifying insurance company is an entity that is subject to regulation as an insurance company under the laws of its country of incorporation and that realizes at least 50 percent of its gross income (other than income from investments) from premiums related to risks located within such country. These exceptions for insurance investment income do not apply to investment income which is received by the CFC from a related person. Similarly, the exceptions do not apply to investment income that is attributable directly or indirectly to the insurance or reinsurance of risks of related persons. The Senate amendment does not change the rule of present law that investment income of a CFC that is attributable to the issuing or reinsuring of any insurance or annuity contract related to risks outside of its country of organization is taxable as Subpart F insurance income.

The Senate amendment also provides an exception from foreign base company services income for income derived from services performed in connection with the active conduct of a banking, financing, insurance or similar business by a CFC that is predominantly engaged in the active conduct of such business.

Effective date.—The provision applies only to taxable years of foreign corporations beginning in 1998, and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Conference Agreement

The conference agreement generally follows the Senate amendment with modifications.

Under the conference agreement, the temporary exception from foreign personal holding company income applies to income that is derived in the active conduct of a banking, financing or similar business by a CFC that is predominantly engaged in the active conduct of such business. For this purpose, income derived in the active conduct of a banking, financing, or similar business generally is determined under the principles applicable in determining financial services income for foreign tax credit limitation purposes. However, in the case of a corporation that is engaged in the active conduct of a banking or securities business, the income that is eligible for this exception is determined under the principles applicable in determining the income which is treated as nonpassive income for purposes of the passive foreign investment company provisions.

The conferees generally intend that the income of a corporation engaged in the active conduct of a banking or securities business that is eligible for this exception is the income that is treated as nonpassive under the regulations proposed under section 1296(b). See Prop. Treas. Reg. secs. 1.1296–4 and 1.1296–6. In this regard, the conferees intend that eligible income will include income or gains with respect to foreclosed property which is incident to the active conduct of a banking business.

For purposes of the temporary exception, a corporation is considered to be predominantly engaged in the active conduct of a banking, financing, or similar business if it is engaged in the active conduct of a banking or securities business or is a qualified bank affiliate or qualified securities affiliate. In this regard, the conferees intend that a corporation will be considered to be engaged in the active conduct of a banking or securities business if the corporation would be treated as so engaged under the regulations proposed under section 1296(b); the conferees further intend that qualified bank affiliates and qualified securities affiliates will be as determined under such proposed regulations. See Prop. Treas. Reg. secs. 1.1296–4 and 1.1296–6.

Alternatively, a corporation is considered to be engaged in the active conduct of a banking, financing or similar business if more than 70 percent of its gross income is derived from such business from transactions with unrelated persons located within the country under the laws of which the corporation is created or organized. For this purpose, income derived by a qualified business unit of a corporation from transactions with unrelated persons located in the country in which the qualified business unit maintains its principal office and conducts substantial business activity is treated as derived by the corporation from transactions with unrelated persons located within the country in which the corporation is created or organized. A person other than a natural person is considered to be located within the country in which it maintains an office through which it engages in a trade or business and by which the transaction is effected. A natural person is treated as located within the country in which such person is physically located when such person enters into the transaction.

The conference agreement provides a temporary exception from foreign personal holding company income for certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. The rules of this provision of the conference agreement differ from the rules of present-law section 953 of the Code, which determines the subpart F inclusions of a U.S. shareholder relating to insurance income of a CFC. Such insurance income under section 953 generally is computed in accordance with the rules of subchapter L of the Code. The conferees believe that review of the rules of this provision would be appropriate when final guidance under section 953 is published by the Treasury Department.

The conference agreement provides a temporary exception for income (received from a person other than a related person) from investments made by a qualifying insurance company of its reserves or 80 percent of its unearned premiums (as defined for purposes of the provision). For this purpose, in the case of contracts regulated in the country in which sold as property, casualty, or health insurance contracts, unearned premiums and reserves mean unearned premiums and reserves for losses incurred determined using the methods and interest rates that would be used if the qualifying insurance company were subject to tax under subchapter L of the Code. Thus, for this purpose, unearned premiums are determined in accordance with section 832(b)(4), and reserves for losses incurred are determined in accordance with section 832(b)(5) and 846 of the Code (as well as any other rules applicable to a U.S. property and casualty insurance company with respect to such amounts).

In the case of a contract regulated in the country in which sold as a life insurance or annuity contract, the following three alternative rules for determining reserves are provided under the conference agreement. It is intended that any one of the three rules may be elected with respect to a particular line of business.

First, reserves for such contracts may be determined generally under the rules applicable to domestic life insurance companies under subchapter L of the Code, using the methods there specified, but substituting for the interest rates in Code section 807(d)(2)(B) an interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term applicable Federal interest rate ("AFR") (within the meaning of section 1274(d)).

Second, the reserves for such contracts may be determined generally using a preliminary term foreign reserve method, except that the interest rate to be used is the interest rate determined for the country in which the qualifying insurance company was created or organized, calculated in the same manner as the mid-term AFR. If a qualifying insurance company uses such a preliminary term method with respect to contracts insuring risks located in the country in which the company is created or organized, then such method is the method that applies for purposes of this election.

Third, reserves for such contracts may be determined to be equal to the net surrender value of the contract (as defined in section 807(e)(1)(A)).

In no event may the reserve for any contract at any time exceed the foreign statement reserve for the contract, reduced by any catastrophe or deficiency reserve. This rule applies whether the contract is regulated as a property, casualty, health, life insurance, annuity, or any other type of contract.

The conference agreement also provides a temporary exception for income from investment of assets equal to (1) one-third of premiums earned during the taxable year on insurance contracts regulated in the country in which sold as property, casualty, or health insurance contracts, and (2) the greater of 10 percent of reserves, or, in the case of a qualifying insurance company that is a startup company, $10 million. For this purpose, a startup company is a company (including any predecessor) that has not been engaged in the active conduct of an insurance business for more than 5 years. It is intended that the 5-year period commences when the foreign company first is engaged in the active conduct of an insurance business. If the foreign company was formed before being acquired by the U.S. shareholder, the 5-year period commences when the acquired company first was engaged in the active conduct of an insurance business. The conferees intend that in the event of the acquisition of a book of business from another company through an assumption or indemnity reinsurance transaction, the period commences when the acquiring company first engaged in the active conduct of an insurance business, except that if more than a substantial part (e.g., 80 percent) of the business of the ceding company is acquired, then the 5-year period commences when the ceding company first engaged in the active conduct of an insurance business. In addition, it is not intended that reinsurance transactions among related persons be used to multiply the number of 5-year periods.

To prevent the shifting of relatively high-yielding assets to generate investment income that qualifies under this temporary exception, the conference agreement provides that, under rules prescribed by the Secretary, income is allocated to contracts as follows. In the case of contracts that are separate-account-type contracts (including variable contracts not meeting the requirements of section 817), only the income specifically allocable to such contracts is taken into account. In the case of other contracts, income not specifically allocable is allocated ratably among such contracts.

The conference agreement modifies the definition of a qualifying insurance company. Under the conference agreement, a qualifying insurance company means any entity which: (1) is regulated as an insurance company under the laws of the country in which it is incorporated; (2) derives at least 50 percent of its net written premiums from the insurance or reinsurance of risks situated within its country of incorporation; and (3) is engaged in the active conduct of an insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

The conference agreement clarifies that this provision does not apply to investment income (includable in the income of a U.S. shareholder of a CFC pursuant to section 953) allocable to contracts that insure related party risks or risks located in a country other than the country in which the qualifying insurance company is created or organized.

Finally, the conference agreement provides an anti-abuse rule applicable for purposes of these temporary exceptions from foreign personal holding company income. For purposes of applying these exceptions, items with respect to a transaction or series of transactions shall be disregarded if one of the principal purposes of the transaction or transactions is to qualify income or gain for these exceptions, including any change in the method of computing reserves or any other transaction or transactions one of the principal purposes of which is the acceleration or deferral of any item in order to claim the benefits of these exceptions.

The conferees recognize that insurance, banking, financing, and similar businesses are businesses the active conduct of which involves the generation of income, such as interest and dividends, of a type that generally is treated as passive for purposes of subpart F. For purposes of this temporary provision, the conferees intend to delineate the income derived in the active conduct of such businesses, while retaining the present-law anti-deferral rules of subpart F with respect to income not derived in the active conduct of these financial services businesses. However, the conferees recognize that the line between income derived in the active conduct of such businesses and income otherwise derived by entities so engaged can be difficult to draw. The conferees believe that the issues of the determination of income derived in the active conduct of such businesses and the potential mobility of the business activity and income recognition of insurance, banking, financing, and similar businesses require further study. In the event that it becomes necessary to consider a possible extension of the provision in the future, the conferees would invite the comments of taxpayers and the Treasury Department regarding these issues.

5. Treat service income of nonresident alien individuals earned on foreign ships as foreign source income and disregard the U.S. presence of such individuals (sec. 745 of the Senate amendment)

Present Law

Nonresident alien individuals generally are subject to U.S. taxation and withholding on their U.S. source income. Compensation for labor and personal services performed within the United States is considered U.S. source unless such income qualifies for a de minimis exception. To qualify for the exception, the compensation paid to a nonresident alien individual must not exceed $3,000, the compensation must reflect services performed on behalf of a foreign employer, and the individual must be present in the United Sates for not more than 90 days during the taxable year. Special rules apply to exclude certain items from the gross income of a nonresident alien. An exclusion applies to gross income derived by a nonresident alien individual from the international operation of a ship if the country in which such individual is resident provides a reciprocal exemption for U.S. residents. However, this exclusion does not apply to income from personal services performed by an individual crew member on board a ship. Consequently, wages exceeding $3,000 in a taxable year that are earned by nonresident alien individual crew members of a foreign ship while the vessel is within U.S. territory are subject to income taxation by the United States.

U.S. residents are subject to U.S. tax on their worldwide income. In general, a non-U.S. citizen is considered to be a resident of the United States if the individual (1) has entered the United States as a lawful permanent U.S. resident or (2) is present in the United States for 31 or more days during the current calendar year and has been present in the United States for a substantial period of time—183 or more days—during a three-year period computed by weighting toward the present year (the "substantial presence test"). An individual generally is treated as present in the United States on any day if such individual is physically present in the United States at any time during the day. Certain categories of individuals (e.g., foreign government employees and certain students) are not treated as U.S. residents even if they are present in the United States for the requisite period of time. Crew members of a foreign vessel who are on board the vessel while it is stationed within U.S. territorial waters are treated as present in the United States.

House Bill

No provision.

Senate Amendment

The Senate amendment treats gross income of a nonresident alien individual, who is present in the United States as a member of the regular crew of a foreign vessel, from the performance of personal services in connection with the international operation of a ship as income from foreign sources. Thus, such income is exempt from U.S. income and withholding tax. However, such persons are not excluded for purposes of applying the minimum participation standards of section 410 to a plan of the employer. In addition, for purposes of determining whether an individual is a U.S. resident under the substantial presence test, the Senate amendment provides that the days that such individual is present as a member of the regular crew of a foreign vessel are disregarded.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement generally follows the Senate amendment with modifications. The conference agreement provides that the treatment of income of a nonresident alien crew member of a foreign vessel as foreign source income will not apply for purposes of the pension rules and certain employee benefit provisions. The conference agreement further provides that, for purposes of determining whether an individual is a U.S. resident under the substantial presence test, any day that such individual is present as a member of the regular crew of a foreign vessel is disregarded only if the individual does not otherwise engage in trade or business within the United States on such day.

XII. SIMPLIFICATION PROVISIONS RELATING TO INDIVIDUALS AND BUSINESSES

A. Provisions Relating to Individuals

1. Modifications to standard deduction of dependents; AMT treatment of certain minor children (sec. 1201 of the House bill and sec. 1001 of the Senate amendment)

Present Law

Standard deduction of dependents.—The standard deduction of a taxpayer for whom a dependency exemption is allowed on another taxpayer's return can not exceed the lesser of (1) the standard deduction for an individual taxpayer (projected to be $4,250 for 1998) or (2) the greater of $500 (indexed)[1] or the dependent's earned income (sec. 63(c)(5)).

Taxation of unearned income of children under age 14.—The tax on a portion of the unearned income (e.g., interest and dividends) of a child under age 14 is the additional tax that the child's custodial parent would pay if the child's unearned income were included in that parent's income. The portion of the child's unearned income which is taxed at the parent's top marginal rate is the amount by which the child's unearned income is more than the sum of (1) $500[2] (indexed) plus (2) the greater of (a) $500[3] (indexed) or (b) the child's itemized deductions directly connected with the production of the unearned income (sec. 1(g)).

Alternative minimum tax ("AMT") exemption for children under age 14.—Single taxpayers are entitled to an exemption from the alternative minimum tax ("AMT") of $33,750. However, in the case of a child under age 14, his exemption from the AMT, in substance, is the unused alternative minimum tax exemption of the child's custodial parent, limited to sum of earned income and $1,400 (sec. 59(j)).

House Bill

Standard deduction of dependents.—The House bill increases the standard deduction for a taxpayer with respect to whom a dependency exemption is allowed on another taxpayer's return to the lesser of (1) the standard deduction for individual taxpayers or (2) the greater of: (a) $500[4] (indexed for inflation as under present law), or (b) the individual's earned income plus $250. The $250 amount is indexed for inflation after 1998.

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[1] The indexed amount is projected to be $700 for 1998.
[2] Projected to be $700 for 1998.
[3] Projected to be $700 for 1998.
[4] Projected to be $700 for 1998.

Alternative minimum tax exemption for children under age 14.—The House bill increases the AMT exemption amount for a child under age 14 to the lesser of (1) $33,750 or (2) the sum of the child's earned income plus $5,000. The $5,000 amount is indexed for inflation after 1998.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Increase de minimis threshold for estimated tax to $1,000 for individuals (sec. 1202 of the House bill and sec. 1002 of the Senate amendment)

Present Law

An individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax (sec. 6654). An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. The 100 percent of last year's liability safe harbor is modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year. Income tax withholding from wages is considered to be a payment of estimated taxes. In general, payment of estimated taxes must be made quarterly. The addition to tax is not imposed where the total tax liability for the year, reduced by any withheld tax and estimated tax payments, is less than $500.

House Bill

The House bill increases the $500 individual estimated tax de minimis threshold to $1,000.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Optional methods for computing SECA tax combined (sec. 1203 of the House bill)

Present Law

The Self-Employment Contributions Act ("SECA") imposes taxes on net earnings from self-employment to provide social security coverage to self-employed workers. The maximum amount of earnings subject to the SECA tax is coordinated with, and is set at the same level as, the maximum level of wages and salaries subject to FICA taxes ($65,000 for OASDI taxes in 1997 and indexed annually, and without limit for the Hospital Insurance tax). Special rules allow certain self-employed individuals to continue to maintain social security coverage during a period of low income. The method applicable to farmers is slightly more favorable than the method applicable to other self-employed persons.

A farmer may increase his or her self-employment income, for purposes of obtaining social security coverage, by reporting two-thirds of the first $2,400 of gross income as net earnings from self-employment, i.e., the optional amount of net earnings from self-employment would not exceed $1,600. There is no limit on the number of times a farmer may use this method. The optional method for non farm income is similar, also permitting two-thirds of the first $2,400 of gross income to be treated as self-employment income. However, the optional non farm method may not be used more than five times by any individual, and may only be used if the taxpayer had net earnings from self-employment of $400 or more in at least two of the three years immediately preceding the year in which the optional method is elected.

In general, to receive benefits, including Disability Insurance Benefits, under the Social Security Act, a worker must have a minimum number of quarters of coverage. A minimum amount of wages or self-employment income must be reported to obtain a quarter of coverage. A maximum of four quarters of coverage may be obtained each year. In 1978, the amount of earnings required to obtain a quarter of coverage began increasing each year. Starting in 1994, a farmer could obtain only two quarters of coverage under the optional method applicable to farmers.

House Bill

The House bill combines the farm and non farm optional methods into a single combined optional method applicable to all self-employed workers. A self-employed worker may elect to use the optional method an unlimited number of times. If it is used, it must be applied to all self-employment earnings for the year, both farm and non farm.

The $2,400 amount is increased to an amount which would provide four quarters of coverage in 1998 (the "lower limit"). Such amount increases each year based on the earnings requirements under the Social Security Act.

The optional method in this provision is elected on a year-by-year basis. An election for a taxable year must be filed with the original Federal income tax return for the year, and may not be made retroactively by filing an amended return.

Effective date—The provision is effective for taxable years beginning after January 1, 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

4. Treatment of certain reimbursed expenses of rural letter carriers' vehicles (sec. 1204 of the House bill and sec. 1003 of the Senate amendment)

Present Law

A taxpayer who uses his or her automobile for business purposes may deduct the business portion of the actual operation and maintenance expenses of the vehicle, plus depreciation (subject to the limitations of sec. 280F). Alternatively, the taxpayer may elect to utilize a standard mileage rate in computing the deduction allowable for business use of an automobile that has not been fully depreciated. Under this election, the taxpayer's deduction equals the applicable rate multiplied by the number of miles driven for business purposes and is taken in lieu of deductions for depreciation and actual operation and maintenance expenses.

An employee of the U.S. Postal Service may compute his deduction for business use of an automobile in performing services involving the collection and delivery of mail on a rural route by using, for all business use mileage, 150 percent of the standard mileage rate.

Rural letter carriers are paid an equipment maintenance allowance (EMA) to compensate them for the use of their personal automobiles in delivering the mail. The tax consequences of the EMA are determined by comparing it with the automobile expense deductions that each carrier is allowed to claim (using either the actual expenses method or the 150 percent of the standard mileage rate). If the EMA exceeds the allowable automobile expense deductions, the excess generally is subject to tax. If the EMA falls short of the allowable automobile expense deductions, a deduction is allowed only to the extent that the sum of this shortfall and all other miscellaneous itemized deductions exceeds two percent of the taxpayer's adjusted gross income.

House Bill

The House bill repeals the special rate for Postal Service employees of 150 percent of the standard mileage rate. In its place, the House bill requires that the rate of reimbursement provided by the Postal Service to rural letter carriers be considered to be equivalent to their expenses. The rate of reimbursement that is considered to be equivalent to their expenses is the rate of reimbursement contained in the 1991 collective bargaining agreement, which may be increased by no more than the rate of inflation.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Travel expenses of Federal employees participating in a Federal criminal investigation (sec. 1205 of the House bill and sec. 1004 of the Senate amendment)

Present Law

Unreimbursed ordinary and necessary travel expenses paid or incurred by an individual in connection with temporary employment away from home (e.g., transportation costs and the cost of meals and lodging) are generally deductible, subject to the two-percent floor on miscellaneous itemized deductions. Travel expenses paid or incurred in connection with indefinite employment away from home, however, are not deductible. A taxpayer's employment away from home in a single location is indefinite rather than temporary if it lasts for one year or more; thus, no deduction is permitted for travel expenses paid or incurred in connection with such employment (sec. 162(a)). If a taxpayer's employment away from home in a single location lasts for less than one year, whether such employment is temporary or indefinite is determined on the basis of the facts and circumstances.

House Bill

The one-year limitation with respect to deductibility of expenses while temporarily away from home does not include any period during which a Federal employee is certified by the Attorney General (or the Attorney General's designee) as traveling on behalf of the Federal Government in a temporary duty status to investigate or provide support services to the investigation of a Federal crime. Thus, expenses for these individuals during these periods are fully deductible, regardless of the length of the period for which certification is given (provided that the other requirements for deductibility are satisfied).

Effective date.—The provision is effective for amounts paid or incurred with respect to taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

6. Payment of taxes by commercially acceptable means (sec. 1206 of the House bill)

Present Law

Payment of taxes may be made by checks or money orders, to the extent and under the conditions provided by Treasury regulations (sec. 6311).

House Bill

In general

The Internal Revenue Service (IRS) is engaged in a long-term modernization of its information systems, the Tax Systems Modernization (TSM) Program. This modernization is intended to address deficiencies in the current IRS information systems and to plan effectively for future information system needs and requirements. The systems changes are designed to reduce the burden on taxpayers, generate additional revenue through improved voluntary compliance, and achieve productivity gains throughout the IRS. One key element of this program is electronic filing of tax returns.

At the present time, increasing reliance is being placed upon electronic funds transfers for payment of obligations. In light of this, the IRS seeks to integrate these payment methods in its TSM program, including electronic filing of returns, as well as into its traditional collection functions. The House bill allows the IRS to accept payment by any commercially acceptable means that the Secretary deems appropriate, to the extent and under the conditions provided in Treasury regulations. This will include, for example, electronic funds transfers, including those arising from credit cards, debit cards, and charge cards.

The IRS contemplates that it will proceed to negotiate contracts to implement this provision with one or more private sector credit and debit card systems. The House bill provides that the Federal Government may pay fees with respect to any such contracts only out of amounts specifically appropriated for that purpose.

Billing error resolution

In the course of processing these transactions, it will be necessary to resolve billing errors and other disputes. The Internal Revenue Code contains mechanisms for the determination of tax liability, defenses and other taxpayer protections, and the resolution of disputes with respect to those liabilities. The Truth-in-Lending Act contains provisions for determination of credit card liabilities, defenses and other consumer protections, and the resolution of disputes with respect to these liabilities.

The House bill excludes credit card, debit card, and charge card issuers and processing mechanisms from the resolution (such as through the "billing error" resolution process) of tax liability, but makes IRS subject to the Truth-in-Lending provisions insofar as those provisions impose obligations and responsibilities with regard to the "billing error" resolution process. It is not intended that consumers obtain additional ways to dispute their tax liabilities under the Truth-in-Lending provisions.

The House bill also specifically includes the use of debit cards in this provision and provides that the corresponding defenses and "billing error" provisions of the Electronic Fund Transfer Act will apply in a similar manner.

The House bill adds new section 6311(d)(3) to the Code. This section describes the circumstances under which section 161 of the Truth-in-Lending Act ("TILA") and section 908 of the Electronic Fund Transfer Act ("EFTA") apply to disputes that may arise in connection with payments of taxes made by credit card or debit card. Subsections (A) through (C) recognize that "billing errors" relating to the credit card account, such as an error arising from a credit card transaction posted to a cardholder's account without the cardholder's authorization, an amount posted to the wrong cardholder's account, or an incorrect amount posted to a cardholder's account as a result of a computational error or numerical transposition, are governed by the billing error provisions of section 161 of TILA. Similarly, subsections 6311(d)(3) (A)–(C) provide that errors such as those described above which arise in connection with payments of internal revenue taxes made by debit card, are governed by section 908 of EFTA.

The Internal Revenue Code provides that refunds are only authorized to be paid to the person who made the overpayment (generally the taxpayer). Subsection 6311(d)(3)(E), however, provides that where a taxpayer is entitled to receive funds as a result of the correction of a billing error made under section 161 of TILA in connection with a credit card transaction, or under section 908 of EFTA in connection with a debit card transaction, the IRS is authorized to utilize the appropriate credit card or debit card system to initiate a credit to the taxpayer's credit card or debit card account. The IRS may, therefore, provide such funds through the taxpayer's credit card or debit card account rather than directly to the taxpayer.

On the other hand, subsections 6311(d)(3) (A)–(C) provide that any alleged error or dispute asserted by a taxpayer concerning the merits of the taxpayer's underlying tax liability or tax return is governed solely by existing tax laws, and is not subject to section 161 or section 170 of TILA, section 908 of EFTA, or any similar provisions of State law. Absent the exclusion from section 170 of TILA, in a collection action brought against the cardholder by the card issuer the cardholder might otherwise assert as a defense that the IRS had incorrectly computed his tax liability. A collection action initiated by a credit card issuer against the taxpayer/cardholder will be an inappropriate vehicle for the determination of a taxpayer's tax liability, especially since the United States will not be a party to such an action.

Similarly, without the exclusion from section 161 of TILA and section 908 of EFTA, a taxpayer could contest the merits of his tax liability by putting the charge which appears on the credit card bill in dispute. Pursuant to TILA or EFTA, the taxpayer's card issuer will have to investigate the dispute, thereby finding itself in the middle of a dispute between the IRS and the taxpayer. It is believed that it is improper to attempt to resolve tax disputes through the billing process. It is also noted that the taxpayer retains the traditional, existing remedies for resolving tax disputes, such as resolving the dispute administratively with the IRS, filing a petition with the Tax Court after receiving a statutory notice of deficiency, or paying the disputed tax and filing a claim for refund (and subsequently filing a refund suit if the claim is denied or not acted upon).

Creditor status

The TILA imposes various responsibilities and obligations on creditors. Although the definition of the term "creditor" set forth in 15 U.S.C. sec. 1602 is limited, and will generally not include the IRS, in the case of an open-end credit plan involving a credit card, the card issuer and any person who honors the credit card are, pursuant to 15 U.S.C. sec. 1602(f), creditors.

In addition, 12 CFR sec. 226.12(e) provides that the creditor must transmit a credit statement to the card issuer within 7 business days from accepting the return or forgiving the debt. There is a concern that the response deadlines otherwise imposed by 12 CFR sec. 226.12(e), if applicable, will be difficult for the IRS to comply with (given the volume of payments the IRS is likely to receive in peak periods). This could subject the IRS to unwarranted damage actions. Consequently, the House bill generally provides an exception to creditor status for the IRS.

Privacy protections

The House bill also addresses privacy questions that arise from the IRS' participation in credit card processing systems. It is believed that taxpayers expect that the maximum possible protection of privacy will be accorded any transactions they have with the IRS. Accordingly, the House bill provides the greatest possible protection of taxpayers' privacy that is consistent with developing and operating an efficient tax administration system. It is expected that the principle will be fully observed in the implementation of this provision.

A key privacy issue is the use and redisclosure of tax information by financial institutions for purposes unrelated to the processing of credit card charges, i.e., marketing and related uses. To accept credit card charges by taxpayers, the IRS will have to disclose tax information to financial institutions to obtain payment and to resolve billing disputes. To obtain payment, the IRS will have to disclose, at a minimum, information on the "credit slip," i.e., the dollar amount of the payment and the taxpayer's credit card number.

The resolution of billing disputes may require the disclosure of additional tax information to financial institutions. In most cases, providing a copy of the credit slip and verifying the transaction amount will be sufficient. Conceivably, financial institutions could require some information regarding the underlying liability even where the dispute concerns a "billing dispute" matter. This additional information will not necessarily be shared as widely as the initial payment data. In lieu of disclosing further information, the IRS may elect to allow disputed amounts to be charged back to the IRS and to reinstate the corresponding tax liability.

Despite the language in most cardholder agreements that permits redisclosure of credit card transaction information, the public may be largely unaware of how widely that information is shared. For example, some financial institutions may share credit, payment, and purchase information with private credit bureaus, who, in turn, may sell this information to direct mail marketers, and others. Without use and redisclosure restrictions, taxpayers may discover that some traditionally confidential tax information might be widely disseminated to direct mail marketers and others.

It is intended that credit or debit card transaction information will generally be restricted to those uses necessary to process payments and resolve billing errors, as well as other purposes that are specified in the statute. The House bill directs the Secretary to issue published procedures on what constitutes authorized uses and disclosures. It is anticipated that the Secretary's published procedures will prohibit the use of transaction information for marketing tax-related services by the issuer or any marketing that targets only those who use their credit card to pay their taxes. It is also anticipated that the published procedures will prohibit the sale of transaction information to a third party.

Effective date.—The provision is effective nine months after the date of enactment. The IRS may, in this interim period, conduct internal tests and negotiate with card issuers, but may not accept credit or debit cards for payment of tax liability.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, except that the requirement that a separate appropriation be made for payment by the IRS of credit card fees is deleted, and a prohibition on the payment by the IRS of any fee or the provision of any other consideration is added.

B. Provisions Relating to Businesses Generally

1. Modifications to look-back method for long-term contracts (sec. 1211 of the House bill, and sec. 1011 of the Senate amendment)

Present Law

Taxpayers engaged in the production of property under a long-term contract generally must compute income from the contract under the percentage of completion method. Under the percentage of completion method, a taxpayer must include in gross income for any taxable year an amount that is based on the product of (1) the gross contract price and (2) the percentage of the contract completed as of the end of the year. The percentage of the contract completed as of the end of the year is determined by comparing costs incurred with respect to the contract as of the end of the year with estimated total contract costs.

Because the percentage of completion method relies upon estimated, rather than actual, contract price and costs to determine gross income for any taxable year, a "look-back method" is applied in the year a contract is completed in order to compensate the taxpayer (or the Internal Revenue Service) for the acceleration (or deferral) of taxes paid over the contract term. The first step of the look-back method is to reapply the percentage of completion method using actual contract price and costs rather than estimated contract price and costs. The second step generally requires the taxpayer to recompute its tax liability for each year of the contract using gross income as reallocated under the look-back method. If there is any difference between the recomputed tax liability and the tax liability as previously determined for a year, such difference is treated as a hypothetical underpayment or overpayment of tax to which the taxpayer applies a rate of interest equal to the overpayment rate, compounded daily.[5] The taxpayer receives (or pays) interest if the net amount of interest applicable to hypothetical overpayments exceeds (or is less than) the amount of interest applicable to hypothetical underpayments.

House Bill

Election not to apply the look-back method for de minimis amounts

The House bill provides that a taxpayer may elect not to apply the look-back method with respect to a long-term contract if for each prior contract year, the cumulative taxable income (or loss) under the contract as determined using estimated contract price and costs is within 10 percent of the cumulative taxable income (or loss) as determined using actual contract price and costs.

The House bill also provides that a taxpayer may elect not to reapply the look-back method with respect to a contract if, as of the close of any taxable year after the year the contract is completed, the cumulative taxable income (or loss) under the contract is within 10 percent of the cumulative look-back income (or loss) as of the close of the most recent year in which the look-back method was applied (or would have applied but for the other de minimis exception described above).

Further, the House bill provides that for purposes of the look-back method, only one rate of interest is to apply for each accrual period. An accrual period with respect to a taxable year begins on the day after the return due date (determined without regard to extensions) for the taxable year and ends on such return due date for the following taxable year. The applicable rate of interest is the overpayment rate in effect for the calendar quarter in which the accrual period begins.

Effective date

The provision applies to contracts completed in taxable years ending after the date of enactment. The change in the interest rate calculation also applies for purposes of the look-back method applicable to the income forecast method of depreciation for property placed in service after September 13, 1995.

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[5] The overpayment rate equals the applicable Federal short-term rate plus two percentage points. This rate is adjusted quarterly by the IRS. Thus, in applying the look-back method for a contract year, a taxpayer may be required to use five different interest rates.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Minimum tax treatment of certain property and casualty insurance companies (sec. 1212 of the House bill and sec. 1012 of the Senate amendment)

Present Law

Present law provides that certain property and casualty insurance companies may elect to be taxed only on taxable investment income for regular tax purposes (sec. 831(b)). Eligible property and casualty insurance companies are those whose net written premiums (or if greater, direct written premiums) for the taxable year exceed $350,000 but do not exceed $1,200,000.

Under present law, all corporations including insurance companies are subject to an alternative minimum tax. Alternative minimum taxable income is increased by 75 percent of the excess of adjusted current earnings over alternative minimum taxable income (determined without regard to this adjustment and without regard to net operating losses).

House Bill

The House bill provides that a property and casualty insurance company that elects for regular tax purposes to be taxed only on taxable investment income determines its adjusted current earnings under the alternative minimum tax without regard to any amount not taken into account in determining its gross investment income under section 834(b). Thus, adjusted current earnings of an electing company is determined without regard to underwriting income (or underwriting expense, as provided in sec. 56(g)(4)(B)(i)(II)).

Effective date.—Taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Treatment of construction allowances provided to lessees (sec. 961 of the House bill and sec. 1014 of the Senate amendment)

Present Law

Issues have arisen as to the proper treatment of amounts provided to a lessee by a lessor for property to be constructed and used by the lessee pursuant to the lease ("construction allowances"). In general, incentive payments are includible in income as accessions to wealth.[6] A coordinated issue paper issued by the Internal Revenue Service ("IRS") on October 7, 1996, states the IRS position that construction allowances should generally be included in income in the year received. However, the paper does recognize that amounts received by a lessee from a lessor and expended by the lessee on assets owned by the lessor were not includible in the lessee's income. The issue paper provides that tax ownership is determined by applying a "benefits and burdens of ownership" test that includes an examination of several factors.

House Bill

The House bill provides that the gross income of a lessee does not include amounts received in cash (or treated as a rent reduction) from a lessor under a short-term lease of retail space for the purpose of the lessee's construction or improvement of qualified long-term real property for use in the lessee's trade or business at such retail space. The exclusion only applies to the extent the allowance does not exceed the amount expended by the lessee on the construction or improvement of qualified long-term real property.

The House bill provides that the lessor must treat the amounts expended on the construction allowance as nonresidential real property owned by the lessor.

The House bill contains reporting requirements to ensure that both the lessor and lessee treat such amounts in accordance with the provision. Under regulations, the lessor and the lessee shall, at such times and in such manner as provided by the regulations, furnish to the Secretary of the Treasury information concerning the amounts received (or treated as a rent reduction), the amounts expended on qualified long-term real property, and such other information as the Secretary deems necessary to carry out the provision.

Effective date.—The provision applies to leases entered into after the date of enactment. No inference is intended as to the treatment of amounts that are not subject to the provision.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement generally follows the House bill and the Senate amendment, with a clarification of the coordination of the provision and present-law rule that allows lessors to take losses with respect to certain leasehold improvements abandoned at the end of the term of the lease (sec. 168(i)(8)). In addition, the conferees wish to emphasize that no inference is intended as to the treatment of amounts that are not subject to the provision, and

[6] *John B. White, Inc.* v. *Comm.*, 55 T.C. 729 (1971), aff'd per curiam 458 F. 2d 989 (3d Cir.), cert. denied, 409 U.S. 876 (1972). However, see, e.g., *Federated Department Stores* v. *Comm.*, 51 T.C. 500 (1968) aff'd 426 F. 2d 417 (6th Cir. 1970) and *The May Department Stores Co.* v. *Comm.,* 33 TCM 1128 (1974), aff'd 519 F. 2d 1154 (8th Cir. 1975) with respect to the application of section 118 to certain payments.

that the provisions of the IRS issue paper and present law (including case law) will continue to apply where applicable.

C. Partnership Simplification Provisions

1. General provisions

a. Simplified flow-through for electing large partnerships (sec. 1221 of the House bill and sec. 1021 of the Senate amendment)

Present Law

Treatment of partnerships in general

A partnership generally is treated as a conduit for Federal income tax purposes. Each partner takes into account separately his distributive share of the partnership's items of income, gain, loss, deduction or credit. The character of an item is the same as if it had been directly realized or incurred by the partner. Limitations affecting the computation of taxable income generally apply at the partner level.

The taxable income of a partnership is computed in the same manner as that of an individual, except that no deduction is permitted for personal exemptions, foreign taxes, charitable contributions, net operating losses, certain itemized deductions, or depletion. Elections affecting the computation of taxable income derived from a partnership are made by the partnership, except for certain elections such as those relating to discharge of indebtedness income and the foreign tax credit.

Capital gains

The net capital gain of an individual is taxed generally at the same rates applicable to ordinary income, subject to a maximum marginal rate of 28 percent. Net capital gain is the excess of net long-term capital gain over net short-term capital loss. Individuals with a net capital loss generally may deduct up to $3,000 of the loss each year against ordinary income. Net capital losses in excess of the $3,000 limit may be carried forward indefinitely.

A special rule applies to gains and losses on the sale, exchange or involuntary conversion of certain trade or business assets (sec. 1231). In general, net gains from such assets are treated as long-term capital gains but net losses are treated as ordinary losses.

A partner's share of a partnership's net short-term capital gain or loss and net long-term capital gain or loss from portfolio investments is separately reported to the partner. A partner's share of a partnership's net gain or loss under section 1231 generally is also separately reported.

Deductions and credits

Miscellaneous itemized deductions (e.g., certain investment expenses) are deductible only to the extent that, in the aggregate, they exceed two percent of the individual's adjusted gross income.

In general, taxpayers are allowed a deduction for charitable contributions, subject to certain limitations. The deduction allowed an individual generally cannot exceed 50 percent of the individual's adjusted gross income for the taxable year. The deduction allowed a corporation generally cannot exceed 10 percent of the corporation's taxable income. Excess contributions are carried forward for five years.

A partner's distributive share of a partnership's miscellaneous itemized deductions and charitable contributions is separately reported to the partner.

Each partner is allowed his distributive share of credits against his taxable income.

Foreign taxes

The foreign tax credit generally allows U.S. taxpayers to reduce U.S. income tax on foreign income by the amount of foreign income taxes paid or accrued with respect to that income. In lieu of electing the foreign tax credit, a taxpayer may deduct foreign taxes. The total amount of the credit may not exceed the same proportion of the taxpayer's U.S. tax which the taxpayer's foreign source taxable income bears to the taxpayer's worldwide taxable income for the taxable year.

Unrelated business taxable income

Tax-exempt organizations are subject to tax on income from unrelated businesses. Certain types of income (such as dividends, interest and certain rental income) are not treated as unrelated business taxable income. Thus, for a partner that is an exempt organization, whether partnership income is unrelated business taxable income depends on the character of the underlying income. Income from a publicly traded partnership, however, is treated as unrelated business taxable income regardless of the character of the underlying income.

Special rules related to oil and gas activities

Taxpayers involved in the search for and extraction of crude oil and natural gas are subject to certain special tax rules. As a result, in the case of partnerships engaged in such activities, certain specific information is separately reported to partners.

A taxpayer who owns an economic interest in a producing deposit of natural resources (including crude oil and natural gas) is permitted to claim a deduction for depletion of the deposit as the minerals are extracted. In the case of oil and gas produced in the United States, a taxpayer generally is permitted to claim the greater of a deduction for cost depletion or percentage depletion. Cost depletion is computed by multiplying a taxpayer's adjusted basis in the depletable property by a fraction, the numerator of which is the amount of current year production from the property and the denominator of which is the property's estimated reserves as of the beginning of that year. Percentage depletion is equal to a specified percentage (generally, 15 percent in the case of oil and gas) of gross income from production. Cost depletion is limited to the taxpayer's basis in the depletable property; percentage depletion is not so limited. Once a taxpayer has exhausted its basis in the depletable property, it may continue to claim percentage depletion deductions (generally referred to as "excess percentage depletion").

Certain limitations apply to the deduction for oil and gas percentage depletion. First, percentage depletion is not available to oil and gas producers who also engage (directly or indirectly) in significant levels of oil and gas retailing or refining activities (so-called "integrated producers" of oil and gas). Second, the deduction for percentage depletion may be claimed by a taxpayer only with respect to up to 1,000 barrels-per-day of production. Third, the percentage depletion deduction may not exceed 100 percent of the taxpayer's net income for the taxable year from the depletable oil and gas property. Fourth, a percentage depletion deduction may not be claimed to the extent that it exceeds 65 percent of the taxpayer's pre-percentage depletion taxable income.

In the case of a partnership that owns depletable oil and gas properties, the depletion allowance is computed separately by the partners and not by the partnership. In computing a partner's basis in his partnership interest, basis is increased by the partner's share of any partnership-related excess percentage depletion deductions and is decreased (but not below zero) by the partner's total amount of depletion deductions attributable to partnership property.

Intangible drilling and development costs ("IDCs") incurred with respect to domestic oil and gas wells generally may be deducted at the election of the taxpayer. In the case of integrated producers, no more than 70 percent of IDCs incurred during a taxable year may be deducted. IDCs not deducted are capitalized and generally are either added to the property's basis and recovered through depletion deductions or amortized on a straight-line basis over a 60-month period.

The special treatment granted to IDCs incurred in the pursuit of oil and gas may give rise to an item of tax preference or (in the case of corporate taxpayers) an adjusted current earnings ("ACE") adjustment for the alternative minimum tax. The tax preference item is based on a concept of "excess IDCs." In general, excess IDCs are the excess of IDCs deducted for the taxable year over the amount of those IDCs that would have been deducted had they been capitalized and amortized on a straight-line basis over 120 months commencing with the month production begins from the related well. The amount of tax preference is then computed as the difference between the excess IDC amount and 65 percent of the taxpayer's net income from oil and gas (computed without a deduction for excess IDCs). For IDCs incurred in taxable years beginning after 1992, the ACE adjustment related to IDCs is repealed for taxpayers other than integrated producers. Moreover, beginning in 1993, the IDC tax preference generally is repealed for taxpayers other than integrated producers. In this case, however, the repeal of the excess IDC preference may not result in more than a 40 percent reduction (30 percent for taxable years beginning in 1993) in the amount of the taxpayer's alternative minimum taxable income computed as if that preference had not been repealed.

Passive losses

The passive loss rules generally disallow deductions and credits from passive activities to the extent they exceed income from passive activities. Losses not allowed in a taxable year are suspended and treated as current deductions from passive activities in the next taxable year. These losses are allowed in full when a taxpayer disposes of the entire interest in the passive activity to an unrelated person in a taxable transaction. Passive activities include trade or business activities in which the taxpayer does not materially participate. (Limited partners generally do not materially participate in the activities of a partnership.) Passive activities also include rental activities (regardless of the taxpayer's material participation)[7]. Portfolio income (such as interest and dividends), and expenses allocable to such income, are not treated as income or loss from a passive activity.

The $25,000 allowance also applies to low-income housing and rehabilitation credits (on a deduction equivalent basis), regardless of whether the taxpayer claiming the credit actively participates in the rental real estate activity generating the credit. In addition, the income phaseout range for the $25,000 allowance for rehabilitation credits is $200,000 to $250,000 (rather than $100,000 to $150,000). For interests acquired after December 31, 1989 in partnerships holding property placed in service after that date, the $25,000 deduction-equivalent allowance is permitted for the low-income housing credit without regard to the taxpayer's income.

A partnership's operations may be treated as multiple activities for purposes of the passive loss rules. In such case, the partnership must separately report items of income and deductions from each of its activities.

Income, loss and other items from a publicly traded partnership are treated as separate from income and loss from any other publicly traded partnership, and also as separate from any income or loss from passive activities.

The Omnibus Budget Reconciliation Act of 1993 added a rule, effective for taxable years beginning after December 31, 1993, treating a taxpayer's rental real estate activities in which he materially participates as not subject to limitation under the passive loss rules if the taxpayer meets eligibility requirements relating to real property trades or businesses in which he performs services (sec. 469(c)(7)). Real property trade or business means any real property development, redevelopment, construction, reconstruction, acquisition, conversion, rental, operation, management, leasing, or brokerage trade or business. An individual taxpayer generally meets the eligibility requirements if (1) more than half of the personal services the taxpayer performs in trades or business during the taxable year are performed in real property trades or businesses in which the taxpayer materially participates, and (2) such taxpayer performs more than 750 hours of services during the taxable year in real property trades or businesses in which the taxpayer materially participates.

REMICs

A tax is imposed on partnerships holding a residual interest in a real estate mortgage investment conduit ("REMIC"). The amount of the tax is the amount of excess inclusions allocable to partner-

[7] An individual who actively participates in a rental real estate activity and holds at least a 10-percent interest may deduct up to $25,000 of passive losses. The $25,000 amount phases out as the individual's income increases from $100,000 to $150,000.

ship interests owned by certain tax-exempt organizations ("disqualified organizations") multiplied by the highest corporate tax rate.

Contribution of property to a partnership

In general, a partner recognizes no gain or loss upon the contribution of property to a partnership. However, income, gain, loss and deduction with respect to property contributed to a partnership by a partner must be allocated among the partners so as to take into account the difference between the basis of the property to the partnership and its fair market value at the time of contribution. In addition, the contributing partner must recognize gain or loss equal to such difference if the property is distributed to another partner within five years of its contribution (sec. 704(c)), or if other property is distributed to the contributor within the five year period (sec. 737).

Election of optional basis adjustments

In general, the transfer of a partnership interest or a distribution of partnership property does not affect the basis of partnership assets. A partnership, however, may elect to make certain adjustments in the basis of partnership property (sec. 754). Under a section 754 election, the transfer of a partnership interest generally results in an adjustment in the partnership's basis in its property for the benefit of the transferee partner only, to reflect the difference between that partner's basis for his interest and his proportionate share of the adjusted basis of partnership property (sec. 743(b)). Also under the election, a distribution of property to a partner in certain cases results in an adjustment in the basis of other partnership property (sec. 734(b)).

Terminations

A partnership terminates if either (1) all partners cease carrying on the business, financial operation or venture of the partnership, or (2) within a 12-month period 50 percent or more of the total partnership interests are sold or exchanged (sec. 708).

House Bill

In general

The House bill modifies the tax treatment of an electing large partnership (generally, any partnership that elects under the provision, if the number of partners in the preceding taxable year is 100 or more) and its partners. The provision provides that each partner takes into account separately the partner's distributive share of the following items, which are determined at the partnership level: (1) taxable income or loss from passive loss limitation activities; (2) taxable income or loss from other activities (e.g., portfolio income or loss); (3) net capital gain or loss to the extent allocable to passive loss limitation activities and other activities; (4) tax-exempt interest; (5) net alternative minimum tax adjustment separately computed for passive loss limitation activities and other activities; (6) general credits; (7) low-income housing credit; (8) rehabilitation credit; (9) credit for producing fuel from a nonconventional source;

(10) creditable foreign taxes and foreign source items; and (11) any other items to the extent that the Secretary determines that separate treatment of such items is appropriate.[8] Separate treatment may be appropriate, for example, should changes in the law necessitate such treatment for any items.

Under the House bill, the taxable income of an electing large partnership is computed in the same manner as that of an individual, except that the items described above are separately stated and certain modifications are made. These modifications include disallowing the deduction for personal exemptions, the net operating loss deduction and certain itemized deductions.[9] All limitations and other provisions affecting the computation of taxable income or any credit (except for the at risk, passive loss and itemized deduction limitations, and any other provision specified in regulations) are applied at the partnership (and not the partner) level.

All elections affecting the computation of taxable income or any credit generally are made by the partnership.

Capital gains

Under the House bill, netting of capital gains and losses occurs at the partnership level. A partner in a large partnership takes into account separately his distributive share of the partnership's net capital gain or net capital loss.[10] Such net capital gain or loss is treated as long-term capital gain or loss.

Any excess of net short-term capital gain over net long-term capital loss is consolidated with the partnership's other taxable income and is not separately reported.

A partner's distributive share of the partnership's net capital gain is allocated between passive loss limitation activities and other activities. The net capital gain is allocated to passive loss limitation activities to the extent of net capital gain from sales and exchanges of property used in connection with such activities, and any excess is allocated to other activities. A similar rule applies for purposes of allocating any net capital loss.

Any gains and losses of the partnership under section 1231 are netted at the partnership level. Net gain is treated as long-term capital gain and is subject to the rules described above. Net loss is treated as ordinary loss and consolidated with the partnership's other taxable income.

Deductions

The House bill contains two special rules for deductions. First, miscellaneous itemized deductions are not separately reported to partners. Instead, 70 percent of the amount of such deductions is

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[8] In determining the amounts required to be separately taken into account by a partner, those provisions of the large partnership rules governing computations of taxable income are applied separately with respect to that partner by taking into account that partner's distributive share of the partnership's items of income, gain, loss, deduction or credit. This rule permits partnerships to make otherwise valid special allocations of partnership items to partners.

[9] An electing large partnership is allowed a deduction under section 212 for expenses incurred for the production of income, subject to 70-percent disallowance. No income from an electing large partnership is treated as fishing or farming income.

[10] The term "net capital gain" has the same meaning as in section 1222(11). The term "net capital loss" means the excess of the losses from sales or exchanges of capital assets over the gains from sales or exchanges of capital assets. Thus, the partnership cannot offset any portion of capital losses against ordinary income.

disallowed at the partnership level;[11] the remaining 30 percent is allowed at the partnership level in determining taxable income, and is not subject to the two-percent floor at the partner level.

Second, charitable contributions are not separately reported to partners under the bill. Instead, the charitable contribution deduction is allowed at the partnership level in determining taxable income, subject to the limitations that apply to corporate donors.

Credits in general

Under the House bill, general credits are separately reported to partners as a single item. General credits are any credits other than the low-income housing credit, the rehabilitation credit and the credit for producing fuel from a nonconventional source. A partner's distributive share of general credits is taken into account as a current year general business credit. Thus, for example, the credit for clinical testing expenses is subject to the present law limitations on the general business credit. The refundable credit for gasoline used for exempt purposes and the refund or credit for undistributed capital gains of a regulated investment company are allowed to the partnership, and thus are not separately reported to partners.

In recognition of their special treatment under the passive loss rules, the low-income housing and rehabilitation credits are separately reported.[12] In addition, the credit for producing fuel from a nonconventional source is separately reported.

The House bill imposes credit recapture at the partnership level and determines the amount of recapture by assuming that the credit fully reduced taxes. Such recapture is applied first to reduce the partnership's current year credit, if any; the partnership is liable for any excess over that amount. Under the House bill, the transfer of an interest in an electing large partnership does not trigger recapture.

Foreign taxes

The House bill retains present-law treatment of foreign taxes. The partnership reports to the partner creditable foreign taxes and the source of any income, gain, loss or deduction taken into account by the partnership. Elections, computations and limitations are made by the partner.

Tax-exempt interest

The House bill retains present-law treatment of tax-exempt interest. Interest on a State or local bond is separately reported to each partner.

Unrelated business taxable income

The House bill retains present-law treatment of unrelated business taxable income. Thus, a tax-exempt partner's distributive

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[11] The 70-percent figure is intended to approximate the amount of such deductions that would be denied at the partner level as a result of the 2-percent floor.

[12] It is understood that the rehabilitation and low-income housing credits which are subject to the same passive loss rules (i.e., in the case of the low-income housing credit, where the partnership interest was acquired or the property was placed in service before 1990) could be reported together on the same line.

share of partnership items is taken into account separately to the extent necessary to comply with the rules governing such income.

Passive losses

Under the House bill, a partner in an electing large partnership takes in an electing to account separately his distributive share of the partnership's taxable income or loss from passive loss limitation activities. The term "passive loss limitation activity" means any activity involving the conduct of a trade or business (including any activity treated as a trade or business under sec. 469(c)(5) or (6)) and any rental activity. A partner's share of an electing large partnership's taxable income or loss from passive loss limitation activities is treated as an item of income or loss from the conduct of a trade or business which is a single passive activity, as defined in the passive loss rules. Thus, an electing large partnership generally is not required to separately report items from multiple activities.

A partner in an electing large partnership also takes into account separately his distributive share of the partnership's taxable income or loss from activities other than passive loss limitation activities. Such distributive share is treated as an item of income or expense with respect to property held for investment. Thus, portfolio income (e.g., interest and dividends) is reported separately and is reduced by portfolio deductions and allocable investment interest expense.

In the case of a partner holding an interest in an electing large partnership which is not a limited partnership interest, such partner's distributive share of any items are taken into account separately to the extent necessary to comply with the passive loss rules. Thus, for example, income of an electing large partnership is not treated as passive income with respect to the general partnership interest of a partner who materially participates in the partnership's trade or business.

Under the House bill, the requirement that the passive loss rule be separately applied to each publicly traded partnership (sec. 469(k) of the Code) continues to apply.

Alternative minimum tax

Under the House bill, alternative minimum tax ("AMT") adjustments and preferences are combined at the partnership level. An electing large partnership would report to partners a net AMT adjustment separately computed for passive loss limitation activities and other activities. In determining a partner's alternative minimum taxable income, a partner's distributive share of any net AMT adjustment is taken into account instead of making separate AMT adjustments with respect to partnership items. The net AMT adjustment is determined by using the adjustments applicable to individuals (in the case of partners other than corporations), and by using the adjustments applicable to corporations (in the case of corporate partners). Except as provided in regulations, the net AMT adjustment is treated as a deferral preference for purposes of the section 53 minimum tax credit.

Discharge of indebtedness income

If an electing large partnership has income from the discharge of any indebtedness, such income is separately reported to each partner. In addition, the rules governing such income (sec. 108) are applied without regard to the large partnership rules. Partner-level elections under section 108 are made by each partner separately. Thus, for example, the large partnership provisions do not affect section 108(d)(6), which provides that certain section 108 rules apply at the partner level, or section 108(b)(5), which provides for an election to reduce the basis of depreciable property. The large partnership provisions also do not affect the election under 108(c) (added by the Omnibus Budget Reconciliation Act of 1993) to exclude discharge of indebtedness income with respect to qualified real property business indebtedness.

REMICs

For purposes of the tax on partnerships holding residual interests in REMICs, all interests in an electing large partnership are treated as held by disqualified organizations. Thus, an electing large partnership holding a residual interest in a REMIC is subject to a tax equal to the excess inclusions multiplied by the highest corporate rate. The amount subject to tax is excluded from partnership income.

Election of optional basis adjustments

Under the House bill, an electing large partnership may still elect to adjust the basis of partnership assets with respect to transferee partners. The computation of an electing large partnership's taxable income is made without regard to the section 743(b) adjustment. As under present law, the section 743(b) adjustment is made only with respect to the transferee partner. In addition, an electing large partnership is permitted to adjust the basis of partnership property under section 734(b) if property is distributed to a partner, as under present law.

Terminations

The House bill provides that an electing large partnership does not terminate for tax purposes solely because 50 percent of its interests are sold or exchanged within a 12-month period.

Partnerships and partners subject to large partnership rules

Definition of electing large partnership

An "electing large partnership" is any partnership that elects under the provision, if the number of partners in the preceding taxable year is 100 or more. The number of partners is determined by counting only persons directly holding partnership interests in the taxable year, including persons holding through nominees; persons holding indirectly (e.g., through another partnership) are not counted. Regulations may provide, however, that if the number of partners in any taxable year falls below 100, the partnership may not be treated as an electing large partnership. The election applies to the year for which made and all subsequent years and cannot be revoked without the Secretary's consent.

Special rules for certain service partnerships

An election under this provision is not effective for any partnership if substantially all the partners are: (1) individuals performing substantial services in connection with the partnership's activities, or personal service corporations the owner-employees of which perform such services; (2) retired partners who had performed such services; or (3) spouses of partners who had performed such services. In addition, the term "partner" does not include any individual performing substantial services in connection with the partnership's activities and holding a partnership interest, or an individual who formerly performed such services and who held a partnership interest at the time the individual performed such services.

Exclusion for commodity partnerships

An election under this provision is not effective for any partnership the principal activity of which is the buying and selling of commodities (not described in sec. 1221(1)), or options, futures or forwards with respect to commodities.

Special rules for partnerships holding oil and gas properties

Simplified reporting treatment of electing large partnerships with oil and gas activities

The House bill provides special rules for electing large partnerships with oil and gas activities that operate under the simplified reporting regime. These partnerships are collectively referred to herein as "oil and gas large partnerships." Generally, the House bill provides that an oil and gas large partnership reports information to its partners under the general simplified large partnership reporting regime described above. To prevent the extension of percentage depletion deductions to persons excluded therefrom under present law, however, certain partners are treated as disqualified persons under the House bill.

The treatment of a disqualified person's distributive share of any item of income, gain, loss, deduction, or credit attributable to any partnership oil or gas property is determined under the bill without regard to the special rules applicable to large partnerships. Thus, an oil and gas large partnership reports information related to oil and gas activities to a partner who is a disqualified person in the same manner and to the same extent that it reports such information to that partner under present law. The simplified reporting rules of the bill, however, apply with respect to reporting such a partner's share of items not related to oil and gas activities.

The House bill defines two categories of taxpayers as disqualified persons. The first category encompasses taxpayers who do not qualify for the deduction for percentage depletion under section 613A (i.e., integrated producers of oil and gas). The second category includes any person whose average daily production of oil and gas (for purposes of determining the depletable oil and natural gas quantity under section 613A(c)(2)) is at least 500 barrels for its taxable year in which (or with which) the partnership's taxable year ends. In making this computation, all production of domestic crude oil and natural gas attributable to the partner is taken into account, including such partner's proportionate share of any production of the large partnership.

A taxpayer that falls within a category of disqualified person has the responsibility of notifying any large partnership in which it holds a direct or indirect interest (e.g., through a pass-through entity) of its status as such. Thus, for example, if an integrated producer owns an interest in a partnership which in turn owns an interest in an oil and gas large partnership, it is responsible for providing the management of the electing large partnership information regarding its status as a disqualified person and details regarding its indirect interest in the electing large partnership.

Under the House bill, an oil and gas large partnership computes its deduction for oil and gas depletion under the general statutory rules (subject to certain exceptions described below) under the assumptions that the partnership is the taxpayer and that it qualifies for the percentage depletion deduction. The amount of the depletion deduction, as well as other oil and gas related items, generally are reported to each partner (other than to partners who are disqualified persons) as components of that partner's distributive share of taxable income or loss from passive loss limitation activities. The House bill provides that in computing the partnership's oil and gas percentage depletion deduction, the 1,000-barrel-per-day limitation does not apply. In addition, an oil and gas large partnership is allowed to compute percentage depletion under the bill without applying the 65-percent-of-taxable-income limitation under section 613A(d)(1).

As under present law, an election to deduct IDCs under section 263(c) is made at the partnership level. Since the House bill treats those taxpayers required by the Code (sec. 291) to capitalize 30 percent of IDCs as disqualified persons, an oil and gas large partnership may pass through a full deduction of IDCs to its partners who are not disqualified persons. In contrast to present law, an oil and gas large partnership also has the responsibility with respect to its partners who are not disqualified persons for making an election under section 59(e) to capitalize and amortize certain specified IDCs. Partners who are disqualified persons are permitted to make their own separate section 59(e) elections under the House bill.

Consistent with the general reporting regime for electing large partnerships, the House bill provides that a single AMT adjustment (under either corporate or non-corporate principles, as the case may be) is made and reported to the partners (other than disqualified persons) of an oil and gas large partnership as a separate item. This separately-reported item is affected by the limitation on the repeal of the tax preference for excess IDCs. For purposes of computing this limitation, the bill treats an oil and gas large partnership as the taxpayer. Thus, the limitation on repeal of the IDC preference is applied at the partnership level and is based on the cumulative reduction in the partnership's alternative minimum taxable income resulting from repeal of that preference.

The House bill provides that in making partnership-level computations, any item of income, gain, loss, deduction, or credit attributable to a partner who is a disqualified person is disregarded. For example, in computing the partnership's net income from oil and gas for purposes of determining the IDC preference (if any) to be reported to partners who are not disqualified persons as part of the AMT adjustment, disqualified persons' distributive shares of the partnership's net income from oil and gas are not to be taken into account.

Regulatory authority

The Secretary of the Treasury is granted authority to prescribe such regulations as may be appropriate to carry out the purposes of the provisions.

Effective date

The provisions generally apply to partnership taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

b. Simplified audit procedures for electing large partnerships (sec. 1222 of the House bill and sec. 1022 of the Senate amendment)

Present Law

In general

Prior to 1982, regardless of the size of a partnership, adjustments to a partnership's items of income, gain, loss, deduction, or credit had to be made in separate proceedings with respect to each partner individually. Because a large partnership sometimes had many partners located in different audit districts, adjustments to items of income, gains, losses, deductions, or credits of the partnership had to be made in numerous actions in several jurisdictions, sometimes with conflicting outcomes.

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") established unified audit rules applicable to all but certain small (10 or fewer partners) partnerships. These rules require the tax treatment of all "partnership items" to be determined at the partnership, rather than the partner, level. Partnership items are those items that are more appropriately determined at the partnership level than at the partner level, as provided by regulations.

Under the TEFRA rules, a partner must report all partnership items consistently with the partnership return or must notify the IRS of any inconsistency. If a partner fails to report any partnership item consistently with the partnership return, the IRS may make a computational adjustment and immediately assess any additional tax that results.

Administrative proceedings

Under the TEFRA rules, a partner must report all partnership items consistently with the partnership return or must notify the

IRS of any inconsistency. If a partner fails to report any partnership item consistently with the partnership return, the IRS may make a computational adjustment and immediately assess any additional tax that results.

The IRS may challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. But the IRS must still assess any resulting deficiency against each of the taxpayers who were partners in the year in which the understatement of tax liability arose.

Any partner of a partnership can request an administrative adjustment or a refund for his own separate tax liability. Any partner also has the right to participate in partnership-level administrative proceedings. A settlement agreement with respect to partnership items binds all parties to the settlement.

Tax Matters Partner

The TEFRA rules establish the "Tax Matters Partner" as the primary representative of a partnership in dealings with the IRS. The Tax Matters Partner is a general partner designated by the partnership or, in the absence of designation, the general partner with the largest profits interest at the close of the taxable year. If no Tax Matters Partner is designated, and it is impractical to apply the largest profits interest rule, the IRS may select any partner as the Tax Matters Partner.

Notice requirements

The IRS generally is required to give notice of the beginning of partnership-level administrative proceedings and any resulting administrative adjustment to all partners whose names and addresses are furnished to the IRS. For partnerships with more than 100 partners, however, the IRS generally is not required to give notice to any partner whose profits interest is less than one percent.

Adjudication of disputes concerning partnership items

After the IRS makes an administrative adjustment, the Tax Matters Partner (and, in limited circumstances, certain other partners) may file a petition for readjustment of partnership items in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court.

Statute of limitations

The IRS generally cannot adjust a partnership item for a partnership taxable year if more than 3 years have elapsed since the later of the filing of the partnership return or the last day for the filing of the partnership return.

House Bill

The House bill creates a new audit system for electing large partnerships. The provision defines "electing large partnership" the same way for audit and reporting purposes (generally, any partnership that elects under the reporting provisions, if the number of partners in the preceding taxable year is 100 or more).

As under present law, electing large partnerships and their partners are subject to unified audit rules. Thus, the tax treatment of “partnership items” is determined at the partnership, rather than the partner, level. The term “partnership items” is defined as under present law.

Unlike present law, however, partnership adjustments generally will flow through to the partners for the year in which the adjustment takes effect. Thus, the current-year partners’ share of current-year partnership items of income, gains, losses, deductions, or credits will be adjusted to reflect partnership adjustments that take effect in that year. The adjustments generally will not affect prior-year returns of any partners (except in the case of changes to any partner’s distributive shares).

In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. The imputed underpayment generally is calculated by netting the adjustments to the income and loss items of the partnership and multiplying that amount by the highest tax rate (whether individual or corporate; currently, the top individual rate of 39.6 percent). A partner may not file a claim for credit or refund of his allocable share of the payment. A partnership may make this election only if it meets requirements set forth in Treasury regulations designed to ensure payment (for example, in the case of a foreign partnership).

Regardless of whether a partnership adjustment flows through to the partners, an adjustment must be offset if it requires another adjustment in a year after the adjusted year and before the year the offsetted adjustment takes effect. For example, if a partnership expensed a $1,000 item in year 1, and it was determined in year 4 that the item should have been capitalized and amortized ratably over 10 years, the adjustment in year 4 would be $700, apart from any interest or penalty. (The $900 adjustment for the improper deduction would be offset by $200 of adjustments for amortization deductions.) The year 4 partners would be required to include an additional $700 in income for that year. The partnership may ratably amortize the remaining $700 of expenses in years 4–10.

In addition, the partnership, rather than the partners individually, generally is liable for any interest and penalties that result from a partnership adjustment. Interest is computed for the period beginning on the return due date for the adjusted year and ending on the earlier of the return due date for the partnership taxable year in which the adjustment takes effect or the date the partnership pays the imputed underpayment. Thus, in the above example, the partnership would be liable for 4 years’ worth of interest (on a declining principal amount).

Penalties (such as the accuracy and fraud penalties) are determined on a year-by-year basis (without offsets) based on an imputed underpayment. All accuracy penalty criteria and waiver criteria (such as reasonable cause, substantial authority, etc.) are determined as if the partnership were a taxable individual. Accuracy and fraud penalties are assessed and accrue interest in the same manner as if asserted against a taxable individual.

Any payment (for Federal income taxes, interest, or penalties) that an electing large partnership is required to make is nondeductible.

If a partnership ceases to exist before a partnership adjustment takes effect, the former partners are required to take the adjustment into account, as provided by regulations. Regulations are also authorized to prevent abuse and to enforce efficiently the audit rules in circumstances that present special enforcement considerations (such as partnership bankruptcy).

Administrative proceedings

Under the electing large partnership audit rules, a partner is not permitted to report any partnership items inconsistently with the partnership return, even if the partner notifies the IRS of the inconsistency. The IRS may treat a partnership item that was reported inconsistently by a partner as a mathematical or clerical error and immediately assess any additional tax against that partner.

As under present law, the IRS may challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. Unlike under present law, however, partners will have no right individually to participate in settlement conferences or to request a refund.

Partnership representative

The House bill requires each electing large partnership to designate a partner or other person to act on its behalf. If an electing large partnership fails to designate such a person, the IRS is permitted to designate any one of the partners as the person authorized to act on the partnership's behalf. After the IRS's designation, an electing large partnership could still designate a replacement for the IRS-designated partner.

Notice requirements

Unlike under present law, the IRS is not required to give notice to individual partners of the commencement of an administrative proceeding or of a final adjustment. Instead, the IRS is authorized to send notice of a partnership adjustment to the partnership itself by certified or registered mail. The IRS could give proper notice by mailing the notice to the last known address of the partnership, even if the partnership had terminated its existence.

Adjudication of disputes concerning partnership items

As under present law, an administrative adjustment could be challenged in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court. However, only the partnership, and not partners individually, can petition for a readjustment of partnership items.

If a petition for readjustment of partnership items is filed by the partnership, the court with which the petition is filed will have jurisdiction to determine the tax treatment of all partnership items of the partnership for the partnership taxable year to which the notice of partnership adjustment relates, and the proper allocation of such items among the partners. Thus, the court's jurisdiction is not limited to the items adjusted in the notice.

Statute of limitations

Absent an agreement to extend the statute of limitations, the IRS generally could not adjust a partnership item of an electing large partnership more than 3 years after the later of the filing of the partnership return or the last day for the filing of the partnership return. Special rules apply to false or fraudulent returns, a substantial omission of income, or the failure to file a return. The IRS would assess and collect any deficiency of a partner that arises from any adjustment to a partnership item subject to the limitations period on assessments and collection applicable to the year the adjustment takes effect (secs. 6248, 6501 and 6502).

Regulatory authority

The Secretary of the Treasury is granted authority to prescribe regulations as may be necessary to carry out the simplified audit procedure provisions, including regulations to prevent abuse of the provisions through manipulation. The regulations may include rules that address transfers of partnership interests, in anticipation of a partnership adjustment, to persons who are tax-favored (e.g., corporations with net operating losses, tax-exempt organizations, and foreign partners) or persons who are expected to be unable to pay tax (e.g., shell corporations). For example, if prior to the time a partnership adjustment takes effect, a taxable partner transfers a partnership interest to a nonresident alien to avoid the tax effect of the partnership adjustment, the rules may provide, among other things, that income related to the partnership adjustment is treated as effectively connected taxable income, that the partnership adjustment is treated as taking effect before the partnership interest was transferred, or that the former partner is treated as a current partner to whom the partnership adjustment is allocated.

Effective date

The provision applies to partnership taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with technical modifications.

c. Due date for furnishing information to partners of electing large partnerships (sec. 1223 of the House bill and sec. 1023 of the Senate amendment)

Present Law

A partnership required to file an income tax return with the Internal Revenue Service must also furnish an information return to each of its partners on or before the day on which the income tax return for the year is required to be filed, including extensions. Under regulations, a partnership must file its income tax return on or before the fifteenth day of the fourth month following the end of the partnership's taxable year (on or before April 15, for calendar year partnerships). This is the same deadline by which most individual partners must file their tax returns.

House Bill

The House bill provides that an electing large partnership must furnish information returns to partners by the first March 15 following the close of the partnership's taxable year. Electing large partnerships are those partnerships subject to the simplified reporting and audit rules (generally, any partnership that elects under the reporting provision, if the number of partners in the preceding taxable year is 100 or more).

The House bill also provides that, if the partnership is required to provide copies of the information returns to the Internal Revenue Service on magnetic media, each schedule (such as each Schedule K–1) with respect to each partner is treated as a separate information return with respect to the corrective periods and penalties that are generally applicable to all information returns.

Effective date.—The provision is effective for partnership taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

d. Partnership returns required on magnetic media (sec. 1224 of the House bill and sec. 1024 of the Senate amendment)

Present Law

Partnerships are permitted, but not required, to provide the tax return of the partnership (Form 1065), as well as copies of the schedules sent to each partner (Form K–1), to the Internal Revenue Service on magnetic media.

House Bill

The House bill provides generally that any partnership is required to provide the tax return of the partnership (Form 1065), as well as copies of the schedule sent to each partner (Form K–1), to the Internal Revenue Service on magnetic media. An exception is provided for partnerships with 100 or fewer partners.

Effective date.—The provision is effective for partnership taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

e. Treatment of partnership items of individual retirement arrangements (sec. 1225 of the House bill and sec. 1025 of the Senate amendment)

Present Law

Return filing requirements

An individual retirement account ("IRA") is a trust which generally is exempt from taxation except for the taxes imposed on income from an unrelated trade or business. A fiduciary of a trust that is exempt from taxation (but subject to the taxes imposed on income from an unrelated trade or business) generally is required to file a return on behalf of the trust for a taxable year if the trust has gross income of $1,000 or more included in computing unrelated business taxable income for that year (Treas. Reg. sec. 1.6012–3(a)(5)).

Unrelated business taxable income is the gross income (including gross income from a partnership) derived by an exempt organization from an unrelated trade or business, less certain deductions which are directly connected with the carrying on of such trade or business (sec. 512(a)(1). In calculating unrelated business taxable income, exempt organizations (including IRAs) generally also are permitted a specific deduction of $1,000 (sec. 512(b)(12)).

Unified audits of partnerships

All but certain small partnerships are subject to unified audit rules established by the Tax Equity and Fiscal Responsibility Act of 1982. These rules require the tax treatment of all "partnership items" to be determined at the partnership, rather than the partner, level. Partnership items are those items that are more appropriately determined at the partnership level than at the partner level, including such items as gross income and deductions of the partnership.

House Bill

The House bill modifies the filing threshold for an IRA with an interest in a partnership that is subject to the partnership-level audit rules. A fiduciary of such an IRA could treat the trust's share of partnership taxable income as gross income, for purposes of determining whether the trust meets the $1,000 gross income filing threshold. A fiduciary of an IRA that receives taxable income from a partnership that is subject to partnership-level audit rules of less than $1,000 (before the $1,000 specific deduction) is not required to file an income tax return if the IRA does not have any other income from an unrelated trade or business.

Effective date.—The provision applies to taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Other partnership audit rules

a. Treatment of partnership items in deficiency proceedings (sec. 1231 of the House bill and sec. 1031 of the Senate amendment)

Present Law

Partnership proceedings under rules enacted in TEFRA[13] must be kept separate from deficiency proceedings involving the partners in their individual capacities. Prior to the Tax Court's opinion in *Munro* v. *Commissioner,* 92 T.C. 71 (1989), the IRS computed deficiencies by assuming that all items that were subject to the TEFRA partnership procedures were correctly reported on the taxpayer's return. However, where the losses claimed from TEFRA partnerships were so large that they offset any proposed adjustments to nonpartnership items, no deficiency could arise from a non-TEFRA proceeding, and if the partnership losses were subsequently disallowed in a partnership proceeding, the non-TEFRA adjustments might be uncollectible because of the expiration of the statute of limitations with respect to nonpartnership items.

Faced with this situation in *Munro,* the IRS issued a notice of deficiency to the taxpayer that presumptively disallowed the taxpayer's TEFRA partnership losses for computational purposes only. Although the Tax Court ruled that a deficiency existed and that the court had jurisdiction to hear the case, the court disapproved of the methodology used by the IRS to compute the deficiency. Specifically, the court held that partnership items (whether income, loss, deduction, or credit) included on a taxpayer's return must be completely ignored in determining whether a deficiency exists that is attributable to nonpartnership items.

House Bill

The House bill overrules *Munro* and allows the IRS to return to its prior practice of computing deficiencies by assuming that all TEFRA items whose treatment has not been finally determined had been correctly reported on the taxpayer's return. This eliminates the need to do special computations that involve the removal of TEFRA items from a taxpayer's return, and will restore to taxpayers a prepayment forum with respect to the TEFRA items. In addition, the provision provides a special rule to address the factual situation presented in *Munro.*

Specifically, the House bill provides a declaratory judgment procedure in the Tax Court for adjustments to an oversheltered return. An oversheltered return is a return that shows no taxable in-

[13] Tax Equity and Fiscal Responsibility Act of 1982.

come and a net loss from TEFRA partnerships. In such a case, the IRS is authorized to issue a notice of adjustment with respect to non-TEFRA items, notwithstanding that no deficiency would result from the adjustment. However, the IRS could only issue such a notice if a deficiency would have arisen in the absence of the net loss from TEFRA partnerships.

The Tax Court is granted jurisdiction to determine the correctness of such an adjustment as well as to make a declaration with respect to any other item for the taxable year to which the notice of adjustment relates, except for partnership items and affected items which require partner-level determinations. No tax is due upon such a determination, but a decision of the Tax Court is treated as a final decision, permitting an appeal of the decision by either the taxpayer or the IRS. An adjustment determined to be correct would thus have the effect of increasing the taxable income that is deemed to have been reported on the taxpayer's return. If the taxpayer's partnership items were then adjusted in a subsequent proceeding, the IRS has preserved its ability to collect tax on any increased deficiency attributable to the nonpartnership items.

Alternatively, if the taxpayer chooses not to contest the notice of adjustment within the 90-day period, the bill provides that when the taxpayer's partnership items are finally determined, the taxpayer has the right to file a refund claim for tax attributable to the items adjusted by the earlier notice of adjustment for the taxable year. Although a refund claim is not generally permitted with respect to a deficiency arising from a TEFRA proceeding, such a rule is appropriate with respect to a defaulted notice of adjustment because taxpayers may not challenge such a notice when issued since it does not require the payment of additional tax.

In addition, the House bill incorporates a number of provisions intended to clarify the coordination between TEFRA audit proceedings and individual deficiency proceedings. Under these provisions, any adjustment with respect to a non-partnership item that caused an increase in tax liability with respect to a partnership item would be treated as a computational adjustment and assessed after the conclusion of the TEFRA proceeding. Accordingly, deficiency procedures do not apply with respect to this increase in tax liability, and the statute of limitations applicable to TEFRA proceedings are controlling.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

b. Partnership return to be determinative of audit procedures to be followed (sec. 1232 of the House bill and sec. 1032 of the Senate amendment)

Present Law

TEFRA established unified audit rules applicable to all partnerships, except for partnerships with 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item is the same as that partner's share of every other partnership item. Partners in the exempted partnerships are subject to regular deficiency procedures.

House Bill

The House bill permits the IRS to apply the TEFRA audit procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply. Similarly, the provision permits the IRS to apply the normal deficiency procedures if, based on the partnership's return for the year, the IRS reasonably determines that those procedures should apply.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

c. Provisions relating to statute of limitations

i. Suspend statute when an untimely petition is filed (sec. 1233(a) of the House bill and sec. 1033(a) of the Senate amendment)

Present Law

In a deficiency case, section 6503(a) provides that if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, the period of limitations on assessment and collection is suspended until the decision of the Tax Court becomes final, and for 60 days thereafter. The counterpart to this provision with respect to TEFRA cases is contained in section 6229(d). That section provides that the period of limitations is suspended for the period during which an action may be brought under section 6226 and, if an action is brought during such period, until the decision of the court becomes final, and for 1 year thereafter. As a result of this difference in language, the running of the statute of limitations in a TEFRA case will only be tolled by the filing of a timely petition whereas in a deficiency case, the statute of limitations is tolled by the filing of any petition, regardless of whether the petition is timely.

House Bill

The House bill conforms the suspension rule for the filing of petitions in TEFRA cases with the rule under section 6503(a) pertaining to deficiency cases. Under the provision, the statute of limitations in TEFRA cases is suspended by the filing of any petition under section 6226, regardless of whether the petition is timely or valid, and the suspension will remain in effect until the decision of the court becomes final, and for one year thereafter. Hence, if the statute of limitations is open at the time that an untimely petition is filed, the limitations period would no longer continue to run and possibly expire while the action is pending before the court.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

ii. Suspend statute of limitations during bankruptcy proceedings (sec. 1233(b) of the House bill and sec. 1033(b) of the Senate amendment)

Present Law

The period for assessing tax with respect to partnership items generally is the longer of the periods provided by section 6229 or section 6501. For partnership items that convert to nonpartnership items, section 6229(f) provides that the period for assessing tax shall not expire before the date which is 1 year after the date that the items become nonpartnership items. Section 6503(h) provides for the suspension of the limitations period during the pendency of a bankruptcy proceeding. However, this provision only applies to the limitations periods provided in sections 6501 and 6502.

Under present law, because the suspension provision in section 6503(h) applies only to the limitations periods provided in section 6501 and 6502, some uncertainty exists as to whether section 6503(h) applies to suspend the limitations period pertaining to converted items provided in section 6229(f) when a petition naming a partner as a debtor in a bankruptcy proceeding is filed. As a result, the limitations period provided in section 6229(f) may continue to run during the pendency of the bankruptcy proceeding, notwithstanding that the IRS is prohibited from making an assessment against the debtor because of the automatic stay provisions of the Bankruptcy Code.

House Bill

The House bill clarifies that the statute of limitations is suspended for a partner who is named in a bankruptcy petition. The suspension period is for the entire period during which the IRS is prohibited by reason of the bankruptcy proceeding from making an assessment, and for 60 days thereafter. The provision does not purport to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective with respect to all cases in which the period of limitations has not expired under present law as of the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

iii. Extend statute of limitations for bankrupt TMPs (sec. 1233(c) of the House bill and sec. 1033(c) of the Senate amendment)

Present Law

Section 6229(b)(1)(B) provides that the statute of limitations is extended with respect to all partners in the partnership by an agreement entered into between the tax matters partner (TMP) and the IRS. However, Temp. Treas. Reg. secs. 301.6231(a)(7)–1T(1)(4) and 301.6231(c)–7T(a) provide that upon the filing of a petition naming a partner as a debtor in a bankruptcy proceeding, that partner's partnership items convert to nonpartnership items, and if the debtor was the tax matters partner, such status terminates. These rules are necessary because of the automatic stay provision contained in 11 U.S.C. sec. 362(a)(8). As a result, if a consent to extend the statute of limitations is signed by a person who would be the TMP but for the fact that at the time that the agreement is executed the person was a debtor in a bankruptcy proceeding, the consent would not be binding on the other partners because the person signing the agreement was no longer the TMP at the time that the agreement was executed.

House Bill

The House bill provides that unless the IRS is notified of a bankruptcy proceeding in accordance with regulations, the IRS can rely on a statute extension signed by a person who is the tax matters partner but for the fact that said person was in bankruptcy at the time that the person signed the agreement. Statute extensions granted by a bankrupt TMP in these cases are binding on all of the partners in the partnership. The provision is not intended to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for extension agreements entered into after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

d. Expansion of small partnership exception (sec. 1234 of the House bill and sec. 1034 of the Senate amendment)

Present Law

TEFRA established unified audit rules applicable to all partnerships, except for partnerships with 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and for which each partner's share of each partnership item is the same as that partner's share of every other partnership item. Partners in the exempted partnerships are subject to regular deficiency procedures.

House Bill

The House bill permits a small partnership to have a C corporation as a partner or to specially allocate items without jeopardizing its exception from the TEFRA rules. However, the provision retains the prohibition of present law against having a flow-through entity (other than an estate of a deceased partner) as a partner for purposes of qualifying for the small partnership exception.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

e. Exclusion of partial settlements from 1-year limitation on assessment (sec. 1235 of the House bill and sec. 1035 of the Senate amendment)

Present Law

The period for assessing tax with respect to partnership items generally is the longer of the periods provided by section 6229 or section 6501. For partnership items that convert to nonpartnership items, section 6229(f) provides that the period for assessing tax shall not expire before the date which is 1 year after the date that the items become nonpartnership items. Section 6231(b)(1)(C) provides that the partnership items of a partner for a partnership taxable year become nonpartnership items as of the date the partner enters into a settlement agreement with the IRS with respect to such items.

House Bill

The House bill provides that if a partner and the IRS enter into a settlement agreement with respect to some but not all of the partnership items in dispute for a partnership taxable year and other partnership items remain in dispute, the period for assessing any tax attributable to the settled items is determined as if such agreement had not been entered into. Consequently, the limitations period that is applicable to the last item to be resolved for the partnership taxable year is controlling with respect to all disputed partnership items for the partnership taxable year. The provision does not purport to create any inference as to the proper interpretation of present law.

Effective date.—The provision is effective for settlements entered into after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

f. Extension of time for filing a request for administrative adjustment (sec. 1236 of the House bill and sec. 1036 of the Senate amendment)

Present Law

If an agreement extending the statute is entered into with respect to a non-TEFRA statute of limitations, that agreement also extends the statute of limitations for filing refund claims (sec. 6511(c)). There is no comparable provision for extending the time for filing refund claims with respect to partnership items subject to the TEFRA partnership rules.

House Bill

The House bill provides that if a TEFRA statute extension agreement is entered into, that agreement also extends the statute of limitations for filing refund claims attributable to partnership items or affected items until 6 months after the expiration of the limitations period for assessments.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

g. Availability of innocent spouse relief in context of partnership proceedings (sec. 1237 of the House bill and sec. 1037 of the Senate amendment)

Present Law

In general, an innocent spouse may be relieved of liability for tax, penalties and interest if certain conditions are met (sec. 6013(e)). However, existing law does not provide the spouse of a partner in a TEFRA partnership with a judicial forum to raise the innocent spouse defense with respect to any tax or interest that relates to an investment in a TEFRA partnership.

House Bill

The House bill provides both a prepayment forum and a refund forum for raising the innocent spouse defense in TEFRA cases.

With respect to a prepayment forum, the provision provides that within 60 days of the date that a notice of computational adjustment relating to partnership items is mailed to the spouse of a partner, the spouse could request that the assessment be abated. Upon receipt of such a request, the assessment is abated and any reassessment will be subject to the deficiency procedures. If an abatement is requested, the statute of limitations does not expire before the date which is 60 days after the date of the abatement. If the spouse files a petition with the Tax Court, the Tax Court only has jurisdiction to determine whether the requirements of section 6013(e) have been satisfied. In making this determination, the treatment of the partnership items that gave rise to the liability in question is conclusive.

Alternatively, the House bill provides that the spouse of a partner could file a claim for refund to raise the innocent spouse defense. The claim has to be filed within 6 months from the date that the notice of computational adjustment is mailed to the spouse. If the claim is not allowed, the spouse could file a refund action. For purposes of any claim or suit under this provision, the treatment of the partnership items that gave rise to the liability in question is conclusive.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

h. Determination of penalties at partnership level (sec. 1238 of the House bill and sec. 1038 of the Senate amendment)

Present Law

Partnership items include only items that are required to be taken into account under the income tax subtitle. Penalties are not partnership items since they are contained in the procedure and administration subtitle. As a result, penalties may only be asserted against a partner through the application of the deficiency procedures following the completion of the partnership-level proceeding.

House Bill

The House bill provides that the partnership-level proceeding is to include a determination of the applicability of penalties at the partnership level. However, the provision allows partners to raise any partner-level defenses in a refund forum.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with technical modifications.

i. Provisions relating to Tax Court jurisdiction (sec. 1239 of the House bill and sec. 1039 of the Senate amendment)

Present Law

Improper assessment and collection activities by the IRS during the 150-day period for filing a petition or during the pendency of any Tax Court proceeding, "may be enjoined in the proper court." Present law may be unclear as to whether this includes the Tax Court.

For a partner other than the Tax Matters Partner to be eligible to file a petition for redetermination of partnership items in any court or to participate in an existing case, the period for assessing any tax attributable to the partnership items of that partner must not have expired. Since such a partner would only be treated as a party to the action if the statute of limitations with respect to them was still open, the law is unclear whether the partner would have standing to assert that the statute of limitations had expired with respect to them.

House Bill

The House bill clarifies that an action to enjoin premature assessments of deficiencies attributable to partnership items may be brought in the Tax Court. The provision also permits a partner to participate in an action or file a petition for the sole purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired for that person. Additionally, the provision clarifies that the Tax Court has overpayment jurisdiction with respect to affected items.

Effective date.—The provision is effective for partnership taxable years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with technical modifications.

j. Treatment of premature petitions filed by notice partners or 5-percent groups (sec. 1240 of the House bill and sec. 1040 of the Senate amendment)

Present Law

The Tax Matters Partner is given the exclusive right to file a petition for a readjustment of partnership items within the 90-day period after the issuance of the notice of a final partnership administrative adjustment (FPAA). If the Tax Matters Partner does not file a petition within the 90-day period, certain other partners are permitted to file a petition within the 60-day period after the close of the 90-day period. There are ordering rules for determining which action goes forward and for dismissing other actions.

House Bill

The House bill treats premature petitions filed by certain partners within the 90-day period as being filed on the last day of the following 60-day period under specified circumstances, thus affording the partnership with an opportunity for judicial review that is not available under present law.

Effective date.—The provision is effective with respect to petitions filed after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

k. Bonds in case of appeals from certain proceedings (sec. 1241 of the House bill and sec. 1041 of the Senate amendment)

Present Law

A bond must be filed to stay the collection of deficiencies pending the appeal of the Tax Court's decision in a TEFRA proceeding.

The amount of the bond must be based on the court's estimate of the aggregate deficiencies of the partners.

House Bill

The House bill clarifies that the amount of the bond should be based on the Tax Court's estimate of the aggregate liability of the parties to the action (and not all of the partners in the partnership). For purposes of this provision, the amount of the bond could be estimated by applying the highest individual rate to the total adjustments determined by the Tax Court and doubling that amount to take into account interest and penalties.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

l. Suspension of interest where delay in computational adjustment resulting from certain settlements (sec. 1242 of the House bill and sec. 1042 of the Senate amendment)

Present Law

Interest on a deficiency generally is suspended when a taxpayer executes a settlement agreement with the IRS and waives the restrictions on assessments and collections, and the IRS does not issue a notice and demand for payment of such deficiency within 30 days. Interest on a deficiency that results from an adjustment of partnership items in TEFRA proceedings, however, is not suspended.

House Bill

The House bill suspends interest where there is a delay in making a computational adjustment relating to a TEFRA settlement.

Effective date.—The provision is effective with respect to adjustments relating to taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

m. Special rules for administrative adjustment requests with respect to bad debts or worthless securities (sec. 1243 of the House bill and sec. 1043 of the Senate amendment)

Present Law

The non-TEFRA statute of limitations for filing a claim for credit or refund generally is the later of (1) three years from the date the return in question was filed or (2) two years from the date the claimed tax was paid, whichever is later (sec. 6511(b)). However, an extended period of time, seven years from the date the return was due, is provided for filing a claim for refund of an overpayment resulting from a deduction for a worthless security or bad debt (sec. 6511(d)).

Under the TEFRA partnership rules, a request for administrative adjustment ("RAA") must be filed within three years after the later of (1) the date the partnership return was filed or (2) the due date of the partnership return (determined without regard to extensions) (sec. 6227(a)(1)). In addition, the request must be filed before a final partnership administrative adjustment ("FPAA") is mailed for the taxable year (sec. 6227(a)(2)). There is no special provision for extending the time for filing an RAA that relates to a deduction for a worthless security or an entirely worthless bad debt.

House Bill

The House bill extends the time for the filing of an RAA relating to the deduction by a partnership for a worthless security or bad debt. In these circumstances, in lieu of the three-year period provided in sec. 6227(a)(1), the period for filing an RAA is seven years from the date the partnership return was due with respect to which the request is made (determined without regard to extensions). The RAA is still required to be filed before the FPAA is mailed for the taxable year.

Effective date.—The provision is effective as if included in the amendments made by section 402 of the Tax Equity and Fiscal Responsibility Act of 1982.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Closing of partnership taxable year with respect to deceased partner (sec. 1246 of the House bill and sec. 1046 of the Senate amendment)

Present Law

The partnership taxable year closes with respect to a partner whose entire interest is sold, exchanged, or liquidated. Such year, however, generally does not close upon the death of a partner.

Thus, a decedent's entire share of items of income, gain, loss, deduction and credit for the partnership year in which death occurs is taxed to the estate or successor in interest rather than to the decedent on his or her final income tax return. See *Estate of Hesse* v. *Commissioner,* 74 T.C. 1307, 1311 (1980).

House Bill

The House bill provides that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation or otherwise. The provision does not change present law with respect to the effect upon the partnership taxable year of a transfer of a partnership interest by a debtor to the debtor's estate (under Chapters 7 or 11 of Title 11, relating to bankruptcy).

Effective date.—Partnership taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

D. Modifications of Rules for Real Estate Investment Trusts (secs. 1251–1263 of the House bill and secs. 1051–1063 of the Senate amendment)

Present Law

Overview

In general, a real estate investment trust ("REIT") is an entity that receives most of its income from passive real estate related investments and that receives conduit treatment for income that is distributed to shareholders. If an entity meets the qualifications for REIT status, the portion of its income that is distributed to the investors each year generally is taxed to the investors without being subjected to a tax at the REIT level; the REIT generally is subject to a corporate tax only on the income that it retains and on certain income from property that qualifies as foreclosure property.

Election to be treated as a REIT

In order to qualify as a REIT, and thereby receive conduit treatment, an entity must elect REIT status. A newly-electing entity generally cannot have earnings and profits accumulated from any year in which the entity was in existence and not treated as a REIT (sec. 857(a)(3)). To satisfy this requirement, the entity must distribute, during its first REIT taxable year, any earnings and profits that were accumulated in non-REIT years. For this purpose, distributions by the entity generally are treated as being made from the most recently accumulated earnings and profits.

Taxation of REITs

Overview

In general, if an entity qualifies as a REIT by satisfying the various requirements described below, the entity is taxable as a corporation on its "real estate investment trust taxable income" ("REITTI"), and also is taxable on certain other amounts (sec. 857). REITTI is the taxable income of the REIT with certain adjustments (sec. 857(b)(2)). The most significant adjustment is a deduction for dividends paid. The allowance of this deduction is the mechanism by which the REIT becomes a conduit for income tax purposes.

Capital gains

A REIT that has a net capital gain for a taxable year generally is subject to tax on such capital gain under the capital gains tax regime generally applicable to corporations (sec. 857(b)(3)). However, a REIT may diminish or eliminate its tax liability attributable to such capital gain by paying a "capital gain dividend" to its shareholders (sec. 857(b)(3)(C)). A capital gain dividend is any dividend or part of a dividend that is designated by the payor REIT as a capital gain dividend in a written notice mailed to shareholders. Shareholders who receive capital gain dividends treat the amount of such dividends as long-term capital gain regardless of the holding period of their stock (sec. 857(b)(3)(C)).

A regulated investment company ("RIC"), but not a REIT, may elect to retain and pay income tax on net long-term capital gains it received during the tax year. If a RIC makes this election, the RIC shareholders must include in their income as long-term capital gains their proportionate share of these undistributed long-term capital gains as designated by the RIC. The shareholder is deemed to have paid the shareholder's share of the tax, which can be credited or refunded to the shareholder. Also, the basis of the shareholder's shares is increased by the amount of the undistributed long-term capital gains (less the amount of capital gains tax paid by the RIC) included in the shareholder's long-term capital gains.

Income from foreclosure property

In addition to tax on its REITTI, a REIT is subject to tax at the highest rate of tax paid by corporations on its net income from foreclosure property (sec. 857(b)(4)). Net income from foreclosure property is the excess of the sum of gains from foreclosure property that is held for sale to customers in the ordinary course of a trade or business and gross income from foreclosure property (other than income that otherwise would qualify under the 75-percent income test described below) over all allowable deductions directly connected with the production of such income.

Foreclosure property is any real property or personal property incident to such real property that is acquired by a REIT as a result of default or imminent default on a lease of such property or indebtedness secured by such property, provided that (unless acquired as foreclosure property), such property was not held by the REIT for sale to customers (sec. 856(e)). A property generally may be treated as foreclosure property for a period of two years after the date the property is acquired by the REIT. The IRS may grant extensions of the period for treating the property as foreclosure property if the REIT establishes that an extension of the grace period is necessary for the orderly liquidation of the REIT's interest in the property. The grace period cannot be extended beyond six years from the date the property is acquired by the REIT.

Property will cease to be treated as foreclosure property if, after 90 days after the date of acquisition, the REIT operates the foreclosure property in a trade or business other than through an independent contractor from whom the REIT does not derive or receive any income (sec. 856(e)(4)(C)).

Income or loss from prohibited transactions

In general, a REIT must derive its income from passive sources and not engage in any active trade or business. Accordingly, in addition to the tax on its REITTI and on its net income from foreclosure property, a 100 percent tax is imposed on the net income of a REIT from "prohibited transactions" (sec. 857(b)(6)). A prohibited transaction is the sale or other disposition of property described in section 1221(1) of the Code (property held for sale in the ordinary course of a trade or business) other than foreclosure property. Thus, the 100 percent tax on prohibited transactions helps to ensure that the REIT is a passive entity and may not engage in ordinary retailing activities such as sales to customers of condominium units or subdivided lots in a development project. A safe harbor is provided for certain sales that otherwise might be considered prohibited transactions (sec. 857(b)(6)(C)). The safe harbor is limited to seven or fewer sales a year or, alternatively, any number of sales provided that the aggregate adjusted basis of the property sold does not exceed 10 percent of the aggregate basis of all the REIT's assets at the beginning of the REIT's taxable year.

Requirements for REIT status

A REIT must satisfy four tests on a year-by-year basis: organizational structure, source of income, nature of assets, and distribution of income. These tests are intended to allow conduit treatment in circumstances in which a corporate tax otherwise would be imposed, only if there really is a pooling of investment arrangement that is evidenced by its organizational structure, if its investments are basically in real estate assets, and if its income is passive income from real estate investment, as contrasted with income from the operation of business involving real estate. In addition, substantially all of the entity's income must be passed through to its shareholders on a current basis.

Organizational structure requirements

To qualify as a REIT, an entity must be for its entire taxable year a corporation or an unincorporated trust or association that would be taxable as a domestic corporation but for the REIT provisions, and must be managed by one or more trustees (sec. 856(a)). The beneficial ownership of the entity must be evidenced by transferable shares or certificates of ownership. Except for the first taxable year for which an entity elects to be a REIT, the beneficial ownership of the entity must be held by 100 or more persons, and the entity may not be so closely held by individuals that it would be treated as a personal holding company if all its adjusted gross income constituted personal holding company income. A REIT is disqualified for any year in which it does not comply with regulations to ascertain the actual ownership of the REIT's outstanding shares. Treasury regulations require that the entity request information from certain shareholders regarding shares directly or indirectly owned by them.

Income requirements

Overview

In order for an entity to qualify as a REIT, at least 95 percent of its gross income generally must be derived from certain passive sources (the "95-percent test"). In addition, at least 75 percent of its income generally must be from certain real estate sources (the "75-percent test"), including rents from real property.

In addition, less than 30 percent of the entity's gross income may be derived from gain from the sale or other disposition of stock or securities held for less than one year, real property held less than four years (other than foreclosure property, or property subject to an involuntary conversion within the meaning of sec. 1033), and property that is sold or disposed of in a prohibited transaction (sec. 856(c)(4)).

Definition of rents from real property

For purposes of the income requirements, rents from real property generally include: (1) rents from interests in real property; (2) charges for services customarily rendered or furnished in connection with the rental of real property, whether or not such charges are separately stated; and (3) rent attributable to personal property that is leased under or in connection with a lease of real property, but only if the rent attributable to such personal property does not exceed 15 percent of the total rent for the year under the lease (sec. 856(d)(1)).

Services provided to tenants are regarded as customary if, in the geographic market within which the building is located, tenants in buildings that are of a similar class (for example, luxury apartment buildings) are customarily provided with the service. The furnishing of water, heat, light, and air conditioning, the cleaning of windows, public entrances, exits, and lobbies, the performance of general maintenance, and of janitorial and cleaning services, the collection of trash, the furnishing of elevator services, telephone answering services, incidental storage space, laundry equipment, watchman or guard service, parking facilities and swimming pool facilities are examples of services that are customarily furnished to tenants of a particular class of buildings in many geographical marketing areas (Treas. Reg. sec. 1.856–4(b)).

Exclusion of rents from related tenants

Amounts are not treated as qualified rent if they are received from corporate or noncorporate tenants in which the REIT, directly or indirectly, has an ownership interest of 10 percent or more (sec. 856(d)(2)(B)).

Exclusion of rents where services to tenants are performed by related contractors

Where a REIT furnishes or renders services to the tenants, amounts received or accrued with respect to such property generally are not treated as qualifying rents unless the services are furnished through an independent contractor (sec. 856(d)(2)(C)). A REIT may furnish or render a service directly, however, if the service would not generate unrelated business taxable income under section 512(b)(3) if provided by an organization described in section 511(a)(2). In general, an independent contractor is a person who does not own more than a 35 percent interest in the REIT (sec. 856(d)(3)(A)), and in which no more than a 35 percent interest is held by persons with a 35 percent or greater interest in the REIT (sec. 856(d)(3)(B)).

Constructive ownership rules involving corporations

For purposes of determining the REIT's ownership interest in a tenant and whether a contractor is independent, the attribution rules of section 318 apply, except that 10 percent is substituted for 50 percent where it appears in subparagraph (C) of section 318(a)(2) and 318(a)(3) (sec. 856(d)(5)). Thus, under section 318(a)(2)(C) (as so modified), if 10 or more percent of a REIT or other corporation is owned, directly or indirectly, by or for a person, that person is treated as owning that person's proportionate share of any stock owned directly or indirectly by that corporation.

Constructive ownership rules involving partnerships

Under section 318, stock owned, directly or indirectly, by or for a partnership is considered owned proportionately by its partners (sec. 318(a)(2)(A)). In addition, stock owned, directly or indirectly, by or for a partner is considered owned by the partnership (sec. 318(a)(3)(A)). However, stock constructively owned by a partnership is not considered as owned for purposes of being constructively owned by partners (sec. 318(a)(5)(C)). The following examples illustrate the application of these provisions for purposes of the related tenant and independent contractor rules.

Constructive ownership of tenant

If a REIT owns a 10 percent or greater interest in a person that is a tenant of the REIT, rents paid by that person to the REIT are not qualifying rents to the REIT (sec. 856(d)(2)(B)). Example #1.—If 10 percent or more of a REIT's shares are owned by a partnership and a partner owning a one-percent interest in that partnership also owns a 10-percent or greater interest in a person that is a tenant of the REIT, rents paid by the tenant to the REIT are not qualifying rents to the REIT; the 10-percent or greater interest in the tenant is considered owned by the partnership (sec. 318(a)(3)(A)) and in turn by the REIT (secs. 318(a)(3)(C) and 856(d)(5)). Example #2.—If a REIT owns a 30-percent interest in a partnership that in turn owns a 40-percent interest in a person that is a tenant of the REIT, rents paid by that person to the REIT are not qualifying rents to the REIT because the REIT is considered to own more than 10 percent of the tenant (sec. 318(a)(2)(A)). Example #3.—If 10 percent or more of a REIT's shares are owned by persons who are 50-percent partners in a partnership whose other partners own the entirety of the interests in a tenant of the REIT, none of the interests in the tenant are considered owned by the partners who own interests in the REIT (sec. 318(a)(5)(C)).

Constructive ownership of contractor

If a person providing services to tenants of the REIT owns a greater-than-35-percent interest in the REIT, or if another person owns a greater-than-35-percent interest in both the REIT and a person providing services, amounts received or accrued by the REIT with respect to the property are not qualifying rents because the service provider does not qualify as an independent contractor (sec. 856(d)(3)). Example #4.—If more than 35 percent of a REIT's shares are owned by a partnership and a partner owning a one-percent interest in that partnership also owns a greater-than-35-percent interest in a contractor, that person will not be considered an independent contractor because the partnership owns more than 35 percent of the REIT's shares and will also be considered to own a greater-than-35-percent interest in the contractor (sec. 318(a)(3)A)). Example #5.—If more than 35 percent of a REIT's shares are owned by a person who owns a one-percent interest in a partnership and another one-percent partner in that partnership owns more than 35 percent of the interests in a contractor, the independent contractor definition will not be met because the partnership will be considered to own more than 35 percent interests in both the REIT and the contractor (sec. 318 (a)(3)(A)).

Hedging instruments

Interest rate swaps or cap agreements that protect a REIT from interest rate fluctuations on variable rate debt incurred to acquire or carry real property are treated as securities under the 30-percent test and payments under these agreements are treated as qualifying under the 95-percent test (sec. 856(c)(6)(G)).

Treatment of shared appreciation mortgages

For purposes of the income requirements for qualification as a REIT, and for purposes of the prohibited transaction provisions, any income derived from a "shared appreciation provision" is treated as gain recognized on the sale of the "secured property." For these purposes, a shared appreciation provision is any provision that is in connection with an obligation that is held by the REIT and secured by an interest in real property, which provision entitles the REIT to receive a specified portion of any gain realized on the sale or exchange of such real property (or of any gain that would be realized if the property were sold on a specified date). Secured property for these purposes means the real property that secures the obligation that has the shared appreciation provision.

In addition, for purposes of the income requirements for qualification as a REIT, and for purposes of the prohibited transactions provisions, the REIT is treated as holding the secured property for the period during which it held the shared appreciation provision (or, if shorter, the period during which the secured property was held by the person holding such property), and the secured property is treated as property described in section 1221(1) if it is such property in the hands of the obligor on the obligation to which the shared appreciation provision relates (or if it would be such property if held by the REIT). For purposes of the prohibited transaction safe harbor, the REIT is treated as having sold the secured property at the time that it recognizes income on account of the shared appreciation provision, and any expenditures made by the holder of the secured property are treated as made by the REIT.

Asset requirements

To satisfy the asset requirements to qualify for treatment as a REIT, at the close of each quarter of its taxable year, an entity must have at least 75 percent of the value of its assets invested in real estate assets, cash and cash items, and government securities (sec. 856(c)(5)(A)). Moreover, not more than 25 percent of the value of the entity's assets can be invested in securities of any one issuer (other than government securities and other securities described in the preceding sentence). Further, these securities may not comprise more than five percent of the entity's assets or more than 10 percent of the outstanding voting securities of such issuer (sec. 856(c)(5)(B)). The term real estate assets is defined to mean real property (including interests in real property and mortgages on real property) and interests in REITs (sec. 856(c)(6)(B)).

REIT subsidiaries

Under present law, all the assets, liabilities, and items of income, deduction, and credit of a "qualified REIT subsidiary" are treated as the assets, liabilities, and respective items of the REIT that owns the stock of the qualified REIT subsidiary. A subsidiary of a REIT is a qualified REIT subsidiary if and only if 100 percent of the subsidiary's stock is owned by the REIT at all times that the subsidiary is in existence. If at any time the REIT ceases to own 100 percent of the stock of the subsidiary, or if the REIT ceases to qualify for (or revokes an election of) REIT status, such subsidiary is treated as a new corporation that acquired all of its assets in exchange for its stock (and assumption of liabilities) immediately before the time that the REIT ceased to own 100 percent of the subsidiary's stock, or ceased to be a REIT as the case may be.

Distribution requirements

To satisfy the distribution requirement, a REIT must distribute as dividends to its shareholders during the taxable year an amount equal to or exceeding (i) the sum of 95 percent of its REITTI other than net capital gain income and 95 percent of the excess of its net income from foreclosure property over the tax imposed on that income minus (ii) certain excess noncash income. Excess noncash items include (1) the excess of the amounts that the REIT is required to include in income under section 467 with respect to certain rental agreements involving deferred rents, over the amounts that the REIT otherwise would recognize under its regular method of accounting, (2) in the case of a REIT using the cash method of accounting, the excess of the amount of original issue discount and coupon interest that the REIT is required to take into account with respect to a loan to which section 1274 applies, over the amount of money and fair market value of other property received with respect to the loan, and (3) income arising from the disposition of a real estate asset in certain transactions that failed to qualify as like-kind exchanges under section 1031.

House Bill

Overview

The House bill modifies many of the provisions relating to the requirements for qualification as, and the taxation of, a REIT. In particular, the modifications relate to the general requirements for qualification as a REIT, the taxation of a REIT, the income requirements for qualification as a REIT, and certain other provisions.

Alternative penalty for failure to make requests of shareholders (sec. 1251 of the House bill)

The House bill replaces the rule that disqualifies a REIT for any year in which the REIT failed to comply with Treasury regulations to ascertain its ownership, with an intermediate penalty for failing to do so. The penalty is $25,000 ($50,000 for intentional violations) for any year in which the REIT did not comply with the ownership regulations. The REIT also is required, when requested by the IRS, to send curative demand letters.

In addition, a REIT that complied with the Treasury regulations for ascertaining its ownership, and which did not know, or have reason to know, that it was so closely held as to be classified as a personal holding company, is treated as meeting the requirement that it not be a personal holding company.

De minimis rule for tenant service income (sec. 1252 of the House bill)

The House bill permits a REIT to render a de minimis amount of impermissible services to tenants, or in connection with the management of property, and still treat amounts received with respect to that property as rent. The value of the impermissible services may not exceed one percent of the gross income from the property. For these purposes, the services may not be valued at less than 150 percent of the REIT's direct cost of the services.

Attribution rules applicable to tenant ownership (sec. 1253 of the House bill)

The House bill modifies the application the rule attributing ownership from partners to partnerships (sec. 318(a)(3)(A)) for purposes of defining non-qualifying rent from related persons (sec. 856(d)(2)), so that attribution occurs only when a partner owns directly or indirectly a 25-percent or greater interest in the partnership. Thus, a REIT and a tenant will not be treated as related (and, therefore, rents paid by the tenant to the REIT will not be treated as non-qualifying rents) if the REIT's shares are owned by a partnership and a partner owning a directly and indirectly less-than-25-percent interest in that partnership also owns an interest in the tenant. The related tenant rule (sec. 856(d)(2)(B)) also will not be violated where owners of the REIT and owners of the tenant are partners in a partnership and either the owners of the REIT or the owners of the tenant are directly and indirectly less-than-25-percent partners in the partnership.

Credit for tax paid by REIT on retained capital gains (sec. 1254 of the House bill)

The House bill permits a REIT to elect to retain and pay income tax on net long-term capital gains it received during the tax year, just as a RIC is permitted under present law. Thus, if a REIT made this election, the REIT shareholders would include in their income as long-term capital gains their proportionate share of the undistributed long-term capital gains as designated by the REIT. The shareholder would be deemed to have paid the shareholder's share of the tax, which would be credited or refunded to the shareholder. Also, the basis of the shareholder's shares would be increased by the amount of the undistributed long-term capital gains (less the amount of capital gains tax paid by the REIT) included in the shareholder's long-term capital gains.

Repeal of 30-percent gross income requirement (sec. 1255 of the House bill)

The House bill repeals the rule that requires less than 30 percent of a REIT's gross income be derived from gain from the sale or other disposition of stock or securities held for less than one year, certain real property held less than four years, and property that is sold or disposed of in a prohibited transaction.

Modification of earnings and profits for determining whether REIT has earnings and profits from non-REIT year (sec. 1256 of the House bill)

The House bill changes the ordering rule for purposes of the requirement that newly-electing REITs distribute earnings and profits that were accumulated in non-REIT years. Distributions of accumulated earnings and profits generally are treated as made from the entity's earliest accumulated earnings and profits, rather than the most recently accumulated earnings and profits. These distributions are not treated as distributions for purposes of calculating the dividends paid deduction.

Treatment of foreclosure property (sec. 1257 of the House bill)

The House bill lengthens the original grace period for foreclosure property until the last day of the third full taxable year following the election. The grace period also could be extended for an additional three years by filing a request to the IRS. A REIT could revoke an election to treat property as foreclosure property for any taxable year by filing a revocation on or before its due date for filing its tax return.

In addition, the House bill conforms the definition of independent contractor for purposes of the foreclosure property rule (sec. 856(e)(4)(C)) to the definition of independent contractor for purposes of the general rules (sec. 856(d)(2)(C)).

Payments under hedging instruments (sec. 1258 of the House bill)

The House bill treats income from all hedges that reduce the interest rate risk of REIT liabilities, not just from interest rate swaps and caps, as qualifying income under the 95-percent test. Thus, payments to a REIT under an interest rate swap, cap agreement, option, futures contract, forward rate agreement or any similar financial instrument entered into by the REIT to hedge its indebtedness incurred or to be incurred (and any gain from the sale or other disposition of these instruments) are treated as qualifying income for purposes of the 95-percent test.

Excess noncash income (sec. 1259 of the House bill)

The House bill (1) expands the class of excess noncash items that are not subject to the distribution requirement to include income from the cancellation of indebtedness and (2) extends the treatment of original issue discount and coupon interest as excess noncash items to REITs that use an accrual method of taxation.

Prohibited transaction safe harbor (sec. 1260 of the House bill)

The House bill excludes from the prohibited sales rules property that was involuntarily converted.

Shared appreciation mortgages (sec. 1261 of the House bill)

The House bill provides that interest received on a shared appreciation mortgage is not subject to the tax on prohibited transactions where the property subject to the mortgage is sold within four years of the REIT's acquisition of the mortgage pursuant to a bankruptcy plan of the mortgagor unless the REIT acquired the mortgage knew or had reason to know that the property subject to the mortgage would be sold in a bankruptcy proceeding.

Wholly-owned REIT subsidiaries (sec. 1262 of the House bill)

The House bill permits any corporation wholly-owned by a REIT to be treated as a qualified subsidiary, regardless of whether the corporation had always been owned by the REIT. Where the REIT acquired an existing corporation, any such corporation is treated as being liquidated as of the time of acquisition by the REIT and then reincorporated (thus, any of the subsidiary's pre-REIT built-in gain would be subject to tax under the normal rules of sec. 337). In addition, any pre-REIT earnings and profits of the subsidiary must be distributed before the end of the REIT's taxable year.

Effective date

The House bill is effective for taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is identical to the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. In addition, the conference agreement extends, to the definition of an independent contractor under section 856(d)(3), the modification to the attribution to partnerships of section 318(a)(3)(A) so that attribution occurs only when a partner owns a 25-percent or greater interest in the partnership. Thus, a person providing services will not fail to be an independent contractor (and, therefore, amounts received or accrued by the REIT with respect to the property will not be treated as non-qualifying rents) where the REIT's shares are owned by a partnership and a partner owning a directly and indirectly a less-than-25-percent interest in the partnership also owns an interest in a contractor. Similarly, a contractor will not fail to be an independent contractor where owners of the REIT and owners of the contractor are partners in a partnership and either the owners of the REIT or owners of the tenant are directly and indirectly less-than-25-percent partners in the partnership.

Effective date.—The conference agreement is effective for taxable years beginning after the date of enactment.

E. Repeal the "Short-Short" Test for Regulated Investment Companies (sec. 1271 of the House bill and sec. 1071 of the Senate amendment)

Present Law

To qualify as a regulated investment company ("RIC"), a company must derive less than 30 percent of its gross income from the sale or other disposition of stock or securities held for less than 3 months (the "30-percent test" or "short-short rule").

House Bill

The 30-percent test (or short-short rule) is repealed effective for taxable years ending after the date of enactment.

Senate Amendment

The 30-percent test (or short-short rule) is repealed effective for taxable years beginning after the December 31, 1997.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment effective for taxable years beginning after the date of enactment.

F. Taxpayer Protections

1. Provide reasonable cause exception for additional penalties (sec. 1281 of the House bill and sec. 1081 of the Senate amendment)

Present Law

Many penalties in the Code may be waived if the taxpayer establishes reasonable cause. For example, the accuracy-related penalty (sec. 6662) may be waived with respect to any item if the taxpayer establishes reasonable cause for his treatment of the item and that he acted in good faith (sec. 6664(c)).

House Bill

The House bill provides that the following penalties may be waived if the failure is shown to be due to reasonable cause and not willful neglect:

(1) the penalty for failure to make a report in connection with deductible employee contributions to a retirement savings plan (sec. 6652(g));

(2) the penalty for failure to make a report as to certain small business stock (sec. 6652(k));

(3) the penalty for failure of a foreign corporation to file a return of personal holding company tax (sec. 6683); and

(4) the penalty for failure to make required payments for entities electing not to have the required taxable year (sec. 7519).

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Clarification of period for filing claims for refunds (sec. 1282 of the House bill and sec. 1082 of the Senate amendment)

Present Law

The Code contains a series of limitations on tax refunds. Section 6511 of the Code provides both a limitation on the time period in which a claim for refund can be made (section 6511(a)) and a limitation on the amount that can be allowed as a refund (section 6511(b)). Section 6511(a) provides the general rule that a claim for refund must be filed within 3 years of the date of the return or 2 years of the date of payment of the taxes at issue, whichever is later. Section 6511(b) limits the refund amount that can be covered: if a return was filed, a taxpayer can recover amounts paid within 2 years before the claim. Section 6512(b)(3) incorporates these rules where taxpayers who challenge deficiency notices in Tax Court are found to be entitled to refunds.

In *Commissioner* v. *Lundy,* 116 S. Ct. 647 (1996), the taxpayer had not filed a return, but received a notice of deficiency within 3 years after the date the return was due and challenged the proposed deficiency in Tax Court. The Supreme Court held that the taxpayer could not recover overpayments attributable to withholding during the tax year, because no return was filed and the 2-year "look back" rule applied. Since overwithheld amounts are deemed paid as of the date the taxpayer's return was first due (i.e., more than 2 years before the notice of deficiency was issued), such overpayments could not be recovered. By contrast, if the same taxpayer had filed a return on the date the notice of deficiency was issued, and then claimed a refund, the 3-year "look back" rule would apply, and the taxpayer could have obtained a refund of the overwithheld amounts.

House Bill

The House bill permits taxpayers who initially fail to file a return, but who receive a notice of deficiency and file suit to contest it in Tax Court during the third year after the return due date, to obtain a refund of excessive amounts paid within the 3-year period prior to the date of the deficiency notice.

Effective date.—The provision applies to claims for refund with respect to tax years ending after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Repeal of authority to disclose whether a prospective juror has been audited (sec. 1283 of the House bill and sec. 1083 of the Senate amendment)

Present Law

In connection with a civil or criminal tax proceeding to which the United States is a party, the Secretary must disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service (sec. 6103(h)(5)).

This disclosure requirement, as it has been interpreted by several recent court decisions, has created significant difficulties in the civil and criminal tax litigation process. First, the litigation process can be substantially slowed. It can take the Secretary a considerable period of time to compile the information necessary for a response (some courts have required searches going back as far as 25 years). Second, providing early release of the list of potential jurors to defendants (which several recent court decisions have required, to permit defendants to obtain disclosure of the information from the Secretary) can provide an opportunity for harassment and intimidation of potential jurors in organized crime, drug, and some tax protester cases. Third, significant judicial resources have been expended in interpreting this procedural requirement that might better be spent resolving substantive disputes. Fourth, differing judicial interpretations of this provision have caused confusion. In some instances, defendants convicted of criminal tax offenses have obtained reversals of those convictions because of failures to comply fully with this provision.

House Bill

The House bill repeals the requirement that the Secretary disclose, upon the written request of either party to the lawsuit, whether an individual who is a prospective juror has or has not been the subject of an audit or other tax investigation by the Internal Revenue Service.

Effective date.—The provision is effective for judicial proceedings commenced after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Clarify statute of limitations for items from pass-through entities (sec. 1284 of the House bill and sec. 1084 of the Senate amendment)

Present Law

Pass-through entities (such as S corporations, partnerships, and certain trusts) generally are not subject to income tax on their taxable income. Instead, these entities file information returns and the entities' shareholders (or beneficial owners) report their pro rata share of the gross income and are liable for any taxes due.

Some believe that, prior to 1993, it may have been unclear as to whether the statute of limitations for adjustments that arise from distributions from pass-through entities should be applied at the entity or individual level (i.e., whether the 3-year statute of limitations for assessments runs from the time that the entity files its information return or from the time that a shareholder timely files his or her income tax return). In 1993, the Supreme Court held that the limitations period for assessing the income tax liability of an S corporation shareholder runs from the date the shareholder's return is filed (*Bufferd* v. *Comm.*, 113 S. Ct. 927 (1993)).

House Bill

The House bill clarifies that the return that starts the running of the statute of limitations for a taxpayer is the return of the taxpayer and not the return of another person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Awarding of administrative costs and attorneys fees (sec. 1285 of the House bill)

Present Law

Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding.

No time limit is specified for the taxpayer to apply to the IRS for an award of administrative costs. In addition, no time limit is specified for a taxpayer to appeal to the Tax Court an IRS decision denying an award of administrative costs. Finally, the procedural rules for adjudicating a denial of administrative costs are unclear.

House Bill

The House bill provides that a taxpayer who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the taxpayer was determined to be a prevailing party. The House bill also provides that a taxpayer who seeks to appeal an IRS denial of an administrative cost award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice.

The House bill clarifies that dispositions by the Tax Court of petitions relating only to administrative costs are to be reviewed in the same manner as other decisions of the Tax Court.

Effective date.—The provision is effective with respect to costs incurred in civil actions or proceedings commenced after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Prohibition on browsing (secs. 1286 and 1287 of the House bill and secs. 1085 and 1086 of the Senate amendment)

Present Law

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized willful disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431).

There is no explicit criminal penalty in the Internal Revenue Code for unauthorized inspection (absent subsequent disclosure) of tax returns and return information. Such inspection is, however, explicitly prohibited by the Internal Revenue Service ("IRS").[14] In a recent case, an individual was convicted of violating the Federal wire fraud statute (18 U.S.C. 1343 and 1346) and a Federal computer fraud statute (18 U.S.C. 1030) for unauthorized inspection. However, the U.S. First Circuit Court of Appeals overturned this conviction.[15] Unauthorized inspection of information of any department or agency of the United States (including the IRS) via computer was made a crime under 18 U.S.C. 1030 by the Economic Espionage Act of 1996.[16] This provision does not apply to unauthorized inspection of paper documents.

House Bill

Criminal penalties

The House bill creates a new criminal penalty in the Internal Revenue Code. The penalty is imposed for willful inspection (except as authorized by the Code) of any tax return or return information by any Federal employee or IRS contractor. The penalty also applies to willful inspection (except as authorized) by any State employee or other person who acquired the tax return or return information under specific provisions of section 6103. Upon conviction, the penalty is a fine in any amount not exceeding $1,000,[17] or imprisonment of not more than 1 year, or both, together with the costs of prosecution. In addition, upon conviction, an officer or employee of the United States would be dismissed from office or discharged from employment.

The Congress views any unauthorized inspection of tax returns or return information as a very serious offense; this new criminal penalty reflects that view. The Congress also believes that unauthorized inspection warrants very serious personnel sanctions against IRS employees who engage in unauthorized inspection, and that it is appropriate to fire employees who do this.

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[14] IRS Declaration of Privacy Principles, May 9, 1994.
[15] *U.S. v. Czubinski,* DTR 2/25/97, p. K-2.
[16] P.L. 104-294, sec. 201 (October 11, 1996).
[17] Pursuant to 18 U.S.C. sec. 3571 (added by the Sentencing Reform Act of 1984), the amount of the fine is not more than the greater of the amount specified in this new Code section or $100,000.

Civil damages

The House bill amends the provision providing for civil damages for unauthorized disclosure by also providing for civil damages for unauthorized inspection. Damages are available for unauthorized inspection that occurs either knowingly or by reason of negligence. Accidental or inadvertent inspection that may occur (such as, for example, by making an error in typing in a TIN) would not be subject to damages because it would not meet this standard. The House bill also provides that no damages are available to a taxpayer if that taxpayer requested the inspection or disclosure.

The House bill also requires that, if any person is criminally charged by indictment or information with inspection or disclosure of a taxpayer's return or return information in violation of section 7213 (a) or (b), section 7213A (as added by the bill), or 18 U.S.C. section 1030(a)(2)(B), the Secretary notify that taxpayer as soon as practicable of the inspection or disclosure.

Effective date.—The provision is effective for violations occurring on or after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement does not include these provisions, because they are identical to the provisions of H.R. 1226, which passed the House on April 15, 1997, and which passed the Senate on July 23, 1997, clearing the measure for the President's signature.

XIII. ESTATE, GIFT, AND TRUST SIMPLIFICATION PROVISIONS

1. Eliminate gift tax filing requirements for gifts to charities (sec. 1301 of the House bill and sec. 1101 of the Senate amendment)

Present Law

A gift tax generally is imposed on lifetime transfers of property by gift (sec. 2501). In computing the amount of taxable gifts made during a calendar year, a taxpayer generally may deduct the amount of any gifts made to a charity (sec. 2522). Generally, this charitable gift deduction is available for outright gifts to charity, as well as gifts of certain partial interests in property (such as a remainder interest). A gift of a partial interest in property must be in a prescribed form in order to qualify for the deduction.

Individuals who make gifts in excess of $10,000 to any one donee during the calendar year generally are required to file a gift tax return (sec. 6019). This filing requirement applies to all gifts, whether charitable or noncharitable, and whether or not the gift qualifies for a gift tax charitable deduction. Thus, under current law, a gift tax return is required to be filed for gifts to charity in excess of $10,000, even though no gift tax is payable on the transfer.

House Bill

The House bill provides that gifts to charity are not subject to the gift tax filing requirements of section 6019, as long as the entire value of the transferred property qualifies for the gift tax charitable deduction under section 2522. The filing requirements for gifts of partial interests in property remain unchanged.

Effective date.—The provision is effective for gifts made after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with a technical clarification that the property given to charity must be the donor's entire interest in the property.

2. Clarification of waiver of certain rights of recovery (sec. 1302 of the House bill and sec. 1102 of the Senate amendment)

Present Law

For estate and gift tax purposes, a marital deduction is allowed for qualified terminable interest property (QTIP). Such property generally is included in the surviving spouse's gross estate upon his or her death. The surviving spouse's estate is entitled to recover the portion of the estate tax attributable to inclusion of QTIP from the person receiving the property, unless the spouse directs otherwise by will (sec. 2207A). For this purpose, a will provision specifying that all taxes shall be paid by the estate is sufficient to waive the right of recovery.

A decedent's gross estate includes the value of previously transferred property in which the decedent retains enjoyment or the right to income (sec. 2036). The estate is entitled to recover from the person receiving the property a portion of the estate tax attributable to the inclusion (sec. 2207B). This right may be waived only by a provision in the will (or revocable trust) specifically referring to section 2207B.

House Bill

The House bill provides that the right of recovery with respect to QTIP is waived only to the extent that language in the decedent's will or revocable trust specifically so indicates (e.g., by a specific reference to QTIP, the QTIP trust, section 2044, or section 2207A). Thus, a general provision specifying that all taxes be paid by the estate is no longer sufficient to waive the right of recovery.

The House bill also provides that the right of contribution for property over which the decedent retained enjoyment or the right to income is waived by a specific indication in the decedent's will or revocable trust, but specific reference to section 2207B is no longer required.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Transitional rule under section 2056A (sec. 1303 of the House bill and sec. 1103 of the Senate amendment)

Present Law

A "marital deduction" generally is allowed for estate and gift tax purposes for the value of property passing to a spouse. The Technical and Miscellaneous Revenue Act of 1988 ("TAMRA") denied the marital deduction for property passing to an alien spouse outside a qualified domestic trust (“QDT”). An estate tax generally is imposed on corpus distributions from a QDT.

TAMRA defined a QDT as a trust that, among other things, required all trustees be U.S. citizens or domestic corporations. This provision was modified in the Omnibus Budget Reconciliation Acts of 1989 and 1990 to require that at least one trustee be a U.S. citizen or domestic corporation and that no corpus distribution be made unless such trustee has the right to withhold any estate tax imposed on the distribution (the “withholding requirement”).

House Bill

The House bill provides that certain trusts created before the enactment of the Omnibus Budget Reconciliation Act of 1990 are treated as satisfying the withholding requirement if the governing instruments require that all trustees be U.S. citizens or domestic corporations.

Effective date.—The provision applies as if included in the Omnibus Budget Reconciliation Act of 1990.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Clarifications relating to disclaimers (sec. 1304 of the House bill)

Present Law

Historically, there must be acceptance of a gift in order for the gift to be completed under State law and there is no taxable gift for Federal gift tax purposes unless there is a completed gift. Most States have rules that provide that, where there is a disclaimer of a gift, the property passes to the person who is entitled to the property had the disclaiming party died before the purported transfer.

In the Tax Reform Act of 1976, Congress provided a uniform disclaimer rule (sec. 2518) that specified how and when a disclaimer under State law must be made in order to be effective for Federal transfer tax purposes. Under section 2518, a State law type disclaimer is effective for Federal transfer tax purposes if it is an irrevocable and unqualified refusal to accept an interest in property and certain other requirements are satisfied. One of these other requirements is that the disclaimer generally must be made in writing not later than nine months after the transfer creating the interest occurs. Section 2518 is not currently effective for Federal tax purposes other than transfer taxes.

In 1981, Congress added a rule to section 2518 that allowed certain transfers of property to be treated as a qualified disclaimer. In order to qualify, these transfer-type disclaimers must be a written transfer of the disclaimant’s “entire interest in the property” to persons who would have received the property had there been a valid disclaimer under State law (sec. 2518(c)(3)). Like other disclaimers, the transfer-type disclaimer generally must be made within nine months of the transfer creating the interest.

House Bill

The House bill allows a transfer-type disclaimer of an "undivided portion" of the disclaimant transferor's interest in property to qualify under section 2518. Also, the House bill allows a spouse to make a qualified transfer-type disclaimer where the disclaimed property is transferred to a trust in which the disclaimant spouse has an interest (e.g., a credit shelter trust). Further, the House bill provides that a qualified disclaimer for transfer tax purposes under section 2518 also is effective for Federal income tax purposes (e.g., disclaimers of interests in annuities and income in respect of a decedent).

None of the foregoing provisions are intended to create an inference regarding the Federal tax treatment of disclaimers under present law.

Effective date.—The provision applies to disclaimers made after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

5. Amend "5 or 5 power" (sec. 1305 of the House bill)

Present Law

The exercise or release of a general power of appointment generally is considered a gift by the person holding the power (sec. 2514(b)). A special rule, however, provides that the lapse of a power of appointment during the life of the person holding the power is considered a release (and thus a taxable gift) only to the extent that the value of the property over which the power lapsed exceeds the greater of $5,000 or five percent ("5 or 5 power") of the value of the assets of the trust (sec. 2514(e)). A similar provision applies for purposes of estate taxation (sec. 2041(b)(2)).

House Bill

The House bill increases the limitations in sections 2514(e) and 2041(b)(2) to the greater of $10,000 or 5 percent.

Effective date.—The provision applies to lapses occurring in taxable years beginning after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

6. Treatment for estate tax purposes of short-term obligations held by nonresident aliens (sec. 1306 of the House bill and sec. 1104 of the Senate amendment)

Present Law

The United States imposes estate tax on assets of noncitizen nondomiciliaries that were situated in the United States at the time of the individual's death. Debt obligations of a U.S. person, the United States, a political subdivision of a State, or the District of Columbia are considered property located within the United States if held by a nonresident not a citizen of the United States (sec. 2014(c)).

Special rules apply to treat certain bank deposits and debt instruments the income from which qualifies for the bank deposit interest exemption and the portfolio interest exemption as property from without the United States despite the fact that such items are obligations of a U.S. person, the United States, a political subdivision of a State, or the District of Columbia (sec. 2105(b)). Income from such items is exempt from U.S. income tax in the hands of the nonresident recipient (secs. 871(h) and 871(i)(2)(A)). The effect of these special rules is to exclude these items from the U.S. gross estate of a nonresident not a citizen of the United States. However, because of an amendment to section 871(h) made by the Tax Reform Act of 1986, these special rules no longer cover obligations that generate short-term OID income despite the fact that such income is exempt from U.S. income tax in the hands of the nonresident recipient (sec. 871(g)(1)(B)(i)).

House Bill

The House bill provides that any debt obligation, the income from which would be eligible for the exemption for short-term OID under section 871(g)(1)(B)(i) if such income were received by the decedent on the date of his death, is treated as property located outside of the United States in determining the U.S. estate tax liability of a nonresident not a U.S. citizen. No inference is intended with respect to the estate tax treatment of such obligations under present law.

Effective date.—The provision is effective for estates of decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

7. Certain revocable trusts treated as part of estate (sec. 1307 of the House bill)

Present Law

Both estates and revocable inter vivos trusts can function to settle the affairs of a decedent and distribute assets to heirs. In the case of revocable inter vivos trusts, the grantor transfers property into a trust which is revocable during his or her lifetime. Upon the grantor's death, the power to revoke ceases and the trustee then performs the settlement functions typically performed by the executor of an estate. While both estates and revocable trusts perform essentially the same function after the testator or grantor's death, there are a number of ways in which an estate and a revocable trust operate differently. First, there can be only one estate per decedent while there can be more than one revocable trust. Second, estates are in existence only for a reasonable period of administration; revocable trusts can perform the same settlement functions as an estate, but may continue in existence thereafter as testamentary trusts.

Numerous differences presently exist between the income tax treatment of estates and revocable trusts, including: (1) estates are allowed a charitable deduction for amounts permanently set aside for charitable purposes while post death revocable trusts are allowed a charitable deduction only for amounts paid to charities; (2) the active participation requirement the passive loss rules under section 469 is waived in the case of estates (but not revocable trusts) for two years after the owner's death; and (3) estates (but not revocable trusts) can qualify for section 194 amortization of reforestation expenditures.

House Bill

The House bill provides an irrevocable election to treat a qualified revocable trust as part of the decedent's estate for Federal income tax purposes. This elective treatment is effective from the date of the decedent's death until two years after his or her death (if no estate tax return is required) or, if later, six months after the final determination of estate tax liability (if an estate tax return is required). The election must be made by both the executor of the decedent's estate (if any) and the trustee of the revocable trust no later than the time required for filing the income tax return of the estate for its first taxable year, taking into account any extensions. A conforming change is made to section 2652(b) for generation-skipping transfer tax purposes.

For this purpose, a qualified revocable trust is any trust (or portion thereof) which was treated under section 676 as owned by the decedent with respect to whom the election is being made, by reason of a power in the grantor (i.e., trusts that are treated as owned by the decedent solely by reason of a power in a nonadverse party would not qualify).

The separate share rule (described below) generally will apply when a qualified revocable trust is treated as part of the decedent's estate.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Distributions during first 65 days of taxable year of estate (sec. 1308 of the House bill and sec. 1105 of the Senate amendment)

Present Law

In general, trusts and estates are treated as conduits for Federal income tax purposes; income received by a trust or estate that is distributed to a beneficiary in the trust or estate's taxable year "ending with or within" the taxable year of the beneficiary is taxable to the beneficiary in that year; income that is retained by the trust or estate is initially taxable to the trust or estate. In the case of distributions of previously accumulated income by trusts (but not estates), there may be additional tax under the so-called "throwback" rules if the beneficiary to whom the distributions were made has marginal rates higher than those of the trust. Under the "65-day rule," a trust may elect to treat distributions paid within 65 days after the close of its taxable year as paid on the last day of its taxable year. The 65-day rule is not applicable to estates.

House Bill

The House bill extends application of the 65-day rule to distributions by estates. Thus, an executor can elect to treat distributions paid by the estate within 65 days after the close of the estate's taxable year as having been paid on the last day of such taxable year.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

9. Separate share rules available to estates (sec. 1309 of the House bill and sec. 1106 of the Senate amendment)

Present Law

Trusts with more than one beneficiary must use the "separate share" rule in order to provide different tax treatment of distributions to different beneficiaries to reflect the income earned by different shares of the trust's corpus.[18] Treasury regulations provide that "[t]he application of the separate share rule * * * will generally depend upon whether distributions of the trust are to be made in substantially the same manner as if separate trusts had been created. * * * Separate share treatment will not be applied to a trust or portion of a trust subject to a power to distribute, apportion, or accumulate income or distribute corpus to or for the use of one or more beneficiaries within a group or class of beneficiaries, unless the payment of income, accumulated income, or corpus of a share of one beneficiary cannot affect the proportionate share of income, accumulated income, or corpus of any shares of the other beneficiaries, or unless substantially proper adjustment must thereafter be made under the governing instrument so that substantially separate and independent shares exist." (Treas. Reg. sec. 1.663(c)–3). The separate share rule presently does not apply to estates.

House Bill

The House bill extends the application of the separate share rule to estates. There are separate shares in an estate when the governing instrument of the estate (e.g., the will and applicable local law) creates separate economic interests in one beneficiary or class of beneficiaries such that the economic interests of those beneficiaries (e.g., rights to income or gains from specified items of property) are not affected by economic interests accruing to another separate beneficiary or class of beneficiaries. For example, a separate share in an estate would exist where the decedent's will provides that all of the shares of a closely-held corporation are devised to one beneficiary and that any dividends paid to the estate by that corporation should be paid only to that beneficiary and any such dividends would not affect any other amounts which that beneficiary would receive under the will. As in the case of trusts, the application of the separate share rule is mandatory where separate shares exist.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

[18] Application of the separate share rule is not elective; it is mandatory if there are separate shares in the trust.

10. Executor of estate and beneficiaries treated as related persons for disallowance of losses (sec. 1310 of the House bill and sec. 1107 of the Senate amendment)

Present Law

Section 267 disallows a deduction for any loss on the sale of an asset to a person related to the taxpayer. For the purposes of section 267, the following parties are related persons: (1) a trust and the trust's grantor, (2) two trusts with the same grantor, (3) a trust and a beneficiary of the trust, (4) a trust and a beneficiary of another trust, if both trusts have the same grantor, and (5) a trust and a corporation the stock of which is more than 50 percent owned by the trust or the trust's grantor.

Section 1239 disallows capital gain treatment on the sale of depreciable property to a related person. For purposes of section 1239, a trust and any beneficiary of the trust are treated as related persons, unless the beneficiary's interest is a remote contingent interest.

Neither section 267 or section 1239 presently treat an estate and a beneficiary of the estate as related persons.

House Bill

Under the House bill, an estate and a beneficiary of that estate are treated as related persons for purposes of sections 267 and 1239, except in the case of a sale or exchange in satisfaction of a pecuniary bequest.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

11. Limitation on taxable year of estates (sec. 1311 of the House bill)

Present Law

The taxability of distributions from a trust or estate is based on the amount of income received by the trust or estate in the trust or estate's taxable year "ending with or within" the taxable year of the beneficiary (typically a calendar year). Trusts are required to use a calendar year and, consequently, income of a trust that is distributed to a calendar-year beneficiary in the year earned is taxed to the beneficiary in the year earned. Estates, on the other hand, are allowed to use any fiscal year. Consequently, in the case of estates, the taxation of distributions to a calendar-year beneficiary in up to the last 11 months of the calendar year can be deferred until the next taxable year depending upon the fiscal year selected.

House Bill

The House bill limits the taxable year of an estate to a year ending on October 31, November 30, or December 31.[19] Thus, the maximum deferral allowable to a calendar-year beneficiary is with respect to distributions made in the last two months of the calendar year.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

12. Simplified taxation of earnings of pre-need funeral trusts (sec. 1312 of the House bill and sec. 1108 of the Senate amendment)

Present Law

A pre-need funeral trust is an arrangement where an individual purchases funeral services or merchandise from a funeral home for the benefit of a specified person in advance of that person's death. (The beneficiary may be either the purchaser or another person.) The purchaser enters into a contract with the provider of such services or merchandise whereby the purchaser selects the services or merchandise to be provided upon the death of the beneficiary, and agrees to pay for them in advance of the beneficiary's death. Such amounts (or a portion thereof) are held in trust during the beneficiary's lifetime and are paid to the seller upon the beneficiary's death.

Under present law, pre-need funeral trusts generally are treated as grantor trusts, and the annual income earned by such trusts is taxed to the purchaser/grantor of the trust. Rev. Rul. 87–127. Any amount received from the trust by the seller (as payment for services or merchandise) is includible in the gross income of the seller.

House Bill

The House bill allows the trustee of a pre-need funeral trust to elect special tax treatment for such a trust, to the extent the trust would otherwise be treated as a grantor trust. A qualified funeral trust is defined as one which meets the following requirements: (1) the trust arises as the result of a contract between a person engaged in the trade or business of providing funeral or burial services or merchandise and one or more individuals to have such services or property provided upon such individuals' death; (2) the only beneficiaries of the trust are individuals who have entered

[19] If an election is made to treat a revocable trust as part of the estate under section 14601 of the bill, such trust would switch to the taxable year of the estate during the period that the election was effective.

into contracts to have such services or merchandise provided upon their death; (3) the only contributions to the trust are contributions by or for the benefit of the trust beneficiaries; (4) the trust's only purpose is to hold and invest funds that will be used to make payments for funeral or burial services or merchandise for the trust beneficiaries; and (5) the trust has not accepted contributions totaling more than $7,000 by or for the benefit of any individual. For this purpose, "contributions" include all amounts transferred to the trust, regardless of how denominated in the contract. Contributions do not, however, include income or gain earned with respect to property in the trust. For purposes of applying the $7,000 limit, if a purchaser has more than one contract with a single trustee (or related trustees), all such trusts are treated as one trust. Similarly, if the Secretary of Treasury determines that a purchaser has entered into separate contracts with unrelated trustees to avoid the $7,000 limit described above, the Secretary may require that such trusts be treated as one trust. For contracts entered into after 1998, the $7,000 limit is indexed annually for inflation.

The trustee's election to have this provision apply to a qualified funeral trust is to be made separately with respect to each purchaser's trust. It is anticipated that the Department of Treasury will issue prompt guidance with respect to the simplified reporting requirements so that if the election is made, a single annual trust return may be filed by the trustee, separately listing the amount of income earned with respect to each purchaser. If the election is made, the trust is not treated as a grantor trust and the amount of tax paid with respect to each purchaser's trust is determined in accordance with the income tax rate schedule generally applicable to estates and trusts (Code sec. 1(e)), but no deduction is allowed under section 642(b). The tax on the annual earnings of the trust is payable by the trustee.

As under present law, amounts received from the trust by the seller are treated as payments for services and merchandise and are includible in the gross income of the seller. No gain or loss is recognized to the beneficiary of the trust for payments from the trust to the beneficiary upon cancellation of the contract, and the beneficiary takes a carryover basis in any assets received from the trust upon cancellation.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Senate Agreement

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with modifications that would (1) allow the provision to be applied to contracts purchased by one individual to have funeral or burial services or merchandise provided for another individual upon that individual's death (to the extent that such arrangements would otherwise be treated as grantor trusts), and (2) allow the election to be made for taxable years ending after the date of enactment.

Effective date.—The provision is effective for taxable years ending after the date of enactment.

13. Adjustments for gifts within 3 years of decedent's death (sec. 1313 of the House bill and sec. 1109 of the Senate amendment)

Present Law

The first $10,000 of gifts of present interests to each donee during any one calendar year are excluded from Federal gift tax.

The value of the gross estate includes the value of any previously transferred property if the decedent retained the power to revoke the transfer (sec. 2038). The gross estate also includes the value of any property with respect to which such power is relinquished during the three years before death (sec. 2035). There has been significant litigation as to whether these rules require that certain transfers made from a revocable trust within three years of death be includible in the gross estate. See, e.g., *Jalkut Estate* v. *Commissioner,* 96 T.C. 675 (1991) (transfers from revocable trust includible in gross estate); *McNeely* v. *Commissioner,* 16 F.3d 303 (8th Cir. 1994) (transfers from revocable trust not includible in gross estate); *Kisling* v. *Commissioner,* 32 F.3d 1222 (8th Cir. 1994) (acq.) (transfers from revocable trust not includible in gross estate).

House Bill

The House bill codifies the rule set forth in the *McNeely* and *Kisling* cases to provide that a transfer from a revocable trust (i.e., a trust described under section 676) is treated as if made directly by the grantor. Thus, an annual exclusion gift from such a trust is not included in the gross estate.

The House bill also revises section 2035 to improve its clarity.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The provision is not intended to modify the result reached in the *Kisling* case.

14. Clarify relationship between community property rights and retirement benefits (sec. 1314 of the House bill and sec. 1110 of the Senate amendment)

Present Law

Community property

Under State community property laws, each spouse owns an undivided one-half interest in each community property asset. In community property jurisdictions, a nonparticipant spouse may be treated as having a vested community property interest in either his or her spouse's qualified plan, individual retirement arrangement ("IRA"), or simplified employee pension ("SEP") plan.

Transfer tax treatment of qualified plans

In the Retirement Equity Act of 1984 ("REA"), qualified retirement plans were required to provide automatic survivor benefits (1) in the case of a participant who retires under the plan, in the form of a qualified joint and survivor annuity, and (2) in the case of a vested participant who dies before the annuity starting date and who has a surviving spouse, in the form of a preretirement survivor annuity. A participant generally is permitted to waive such annuities, provided he or she obtains the written consent of his or her spouse.

The Tax Reform Act of 1986 repealed the estate tax exclusion, formerly contained in sections 2039(c) and 2039(d), for certain interests in qualified plans owned by a nonparticipant spouse attributable to community property laws and made certain other changes to conform the transfer tax treatment of qualified and nonqualified plans.

As a result of these changes made by REA and the Tax Reform Act of 1986, the transfer tax treatment of married couples residing in a community property State is unclear where either spouse is covered by a qualified plan.

House Bill

The House bill clarifies that the marital deduction is available with respect to a nonparticipant spouse's interest in an annuity attributable to community property laws where he or she predeceases the participant spouse. Under the House bill, the nonparticipant spouse's interest in an annuity arising under the community property laws of a State that passes to the surviving participant spouse may qualify for treatment as QTIP under section 2056(b)(7).

The provision is not intended to create an inference regarding the treatment under present law of a transfer to a surviving spouse of the decedent spouse's interest in an annuity arising under community property laws.

Effective date.—The provision applies to decedents dying, or waivers, transfers and disclaimers made, after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The provision is not intended to modify the result of the Supreme Court's decision in *Boggs* v. *Boggs,* 117 S.Ct. 1754 (1997).

15. Treatment under qualified domestic trust rules of forms of ownership which are not trusts (sec. 1315 of the House bill and sec. 1111 of the Senate amendment)

Present Law

A marital deduction generally is allowed for estate and gift tax purposes for the value of property passing to a spouse. The marital deduction is not available for property passing to an alien spouse outside a qualified domestic trust ("QDT"). An estate tax generally is imposed on corpus distributions from a QDT.

Trusts are not permitted in some countries (e.g., many civil law countries).[20] As a result, it is not possible to create a QDT in those countries.

House Bill

The House bill provides the Treasury Department with regulatory authority to treat as trusts legal arrangements that have substantially the same effect as a trust. It is anticipated that such regulations, if any, would only permit a marital deduction with respect to non-trust arrangements under which the U.S. would retain jurisdiction and adequate security to impose U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent. Possible arrangements could include the adoption of a bilateral treaty that provides for the collection of U.S. transfer tax from the noncitizen surviving spouse or a closing agreement process under which the surviving spouse waives treaty benefits, allows the U.S. to retain taxing jurisdiction and provides adequate security with respect to such transfer taxes.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

16. Opportunity to correct certain failures under section 2032A (sec. 1316 of the House bill and sec. 1112 of the Senate amendment)

Present Law

For estate tax purposes, an executor may elect to value certain real property used in farming or other closely held business operations at its current use value rather than its highest and best use (sec. 2032A). A written agreement signed by each person with an interest in the property must be filed with the election.

In 1984, section 2032A was amended to provide that if an executor makes a timely election that substantially complies with

[20] Note that in some civil law States (e.g., Louisiana), an entity similar to a trust, called a usufruct, exists.

Treasury regulations, but fails to provide all required information or the signatures of all persons required to enter into the agreement, the executor may supply the missing information within a reasonable period of time (not exceeding 90 days) after notification by the Treasury Department.

Treasury regulations require that a notice of election and certain information be filed with the Federal estate tax return (Treas. Reg. sec. 20.2032A–8). The administrative policy of the Treasury Department is to disallow current use valuation elections unless the required information is supplied.

House Bill

The House bill extends the procedures allowing subsequent submission of information to any executor who makes the election and submits the recapture agreement, without regard to compliance with the Treasury regulations. Thus, the House bill allows the current use valuation election if the executor supplies the required information within a reasonable period of time (not exceeding 90 days) after notification by the IRS. During that time period, the House bill also allows the addition of signatures to a previously filed agreement.

The Committee report on the House bill indicates that the Treasury Department has taken an unnecessarily restrictive view of the 1984 amendment to section 2032A and intends no inference that the Treasury Department lacks the power, under the law in effect prior to the date of enactment, to correct the situation addressed by this provision. The House bill intends that, with respect to technically defective 2032A elections made prior to the date of enactment, prior law should be applied in a manner consistent with the provision.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

17. Authority to waive requirement of U.S. trustee for qualified domestic trusts (sec. 1317 of the House bill and sec. 1113 of the Senate amendment)

Present Law

In order for a trust to be a QDT, a U.S. trustee must have the power to approve all corpus distributions from the trust. In some countries, trusts cannot have any U.S. trustees. As a result, trusts established in those countries cannot qualify as a QDT.

House Bill

In order to permit the establishment of a QDT in those situations where a country prohibits a trust from having a U.S. trustee, the House bill provides the Treasury Department with regulatory authority to waive the requirement that a QDT have a U.S. trustee. It is anticipated that such regulations, if any, provide an alternative mechanism under which the U.S. would retain jurisdiction and adequate security to impose U.S. transfer tax on transfers by the surviving spouse of the property transferred by the decedent.

Effective date.—The provision applies to decedents dying after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

XIV. EXCISE TAX AND OTHER SIMPLIFICATION PROVISIONS

A. Excise Tax Simplification Provisions

1. Increase de minimis limit for after-market alterations subject to heavy truck and luxury automobile excise taxes (sec. 1401 of the House bill and sec. 1201 of the Senate amendment)

Present Law

An excise tax is imposed on retail sales of truck chassis and truck bodies suitable for use in a vehicle with a gross vehicle weight of over 33,000 pounds. The tax is equal to 12 percent of the retail sales price. An excise tax also is imposed on retail sales of luxury automobiles. The tax currently is equal to 8 percent of the amount by which the retail sales price exceeds an inflation-adjusted base. (The rate is reduced by 1 percentage point per year through 2002, and the tax is not imposed after 2002.) Anti-abuse rules prevent the avoidance of these taxes through separate purchases of major component parts. With certain exceptions, tax at the rate applicable to the vehicle is imposed on the subsequent installation of parts and accessories within six months after purchase of a taxable vehicle. The exceptions include a *de minimis* exception for parts and accessories with an aggregate price that does not exceed $200 (or such other amount as Treasury may by regulation prescribe).

House Bill

The tax on subsequent installation of parts and accessories does not apply to parts and accessories with an aggregate price that does not exceed $1,000. Parts and accessories installed on a vehicle on or before that date are taken into account in determining whether the $1,000 threshold is exceeded. If the aggregate price of the pre-effective date parts and accessories does not exceed $200, they are not to be subject to tax unless the aggregate price of all additions exceeds $1,000.

Effective date.—The increase in the threshold for taxing after-market additions under the heavy truck and luxury car excise taxes is effective on January 1, 1998.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Simplification of excise taxes on distilled spirits, wine, and beer (secs. 1411–1422 of the House bill and secs. 1211–1222 of the Senate amendment)

Present Law

Imported distilled spirits returned to plant.—Excise tax that has been paid on domestic distilled spirits is credited or refunded if the spirits are later returned to bonded premises. Tax is imposed on imported bottled spirits when they are withdrawn from customs custody, but the tax is not refunded or credited if the spirits are later returned to bonded premises.

Cancellation of export bonds.—An exporter that withdraws distilled spirits from bonded warehouses for export or transportation to a customs bonded warehouse without the payment of tax must furnish a bond to cover the withdrawal. The required bonds are canceled "on the submission of such evidence, records, and certification indicating exportation as the Secretary may by regulations prescribe."

Location of records of distilled spirits plant.—Proprietors of distilled spirits plants are required to maintain records and reports relating to their production, storage, denaturation, and processing activities on the premises where the operations covered by the record are carried on.

Transfers from brewery to distilled spirits plant.—A distilled spirits plant may receive on its bonded premises beer to be used in the production of distilled spirits only if the beer is produced on contiguous brewery premises.

Sign not required for wholesale dealers.—Wholesale liquor dealers are required to post a sign identifying the firm as such. Failure to do so may subject the wholesaler dealer to a penalty.

Refund on returns of merchantable wine.—Excise tax paid on domestic wine that is returned to bond as unmerchantable is refunded or credited, and the wine is once again treated as wine in bond on the premises of a bonded wine cellar.

Increased sugar limits for certain wine.—Natural wines may be sweetened to correct high acid content. For most wines, however, sugar cannot constitute more than 35 percent (by volume) of the combined sugar and juice used to produce the wine. Up to 60 percent sugar may be used in wine made from loganberries, currants, and gooseberries. If the amount of sugar used exceeds the applicable limitation, the wine must be labeled "substandard."

Beer withdrawn for embassy use.—Imported beer to be used for the family and official use of representatives of foreign governments or public international organizations may be withdrawn from customs bonded warehouses without payment of excise tax. No similar exemption applies to domestic beer withdrawn from a brewery or entered into a bonded customs warehouse for the same authorized use.

Beer withdrawn for destruction.—Removals of beer from a brewery are exempt from tax if the removal is for export, because the beer is unfit for beverage use, for laboratory analysis, research, development and testing, for the brewer's personal or family use, or as supplies for certain vessels and aircraft.

Drawback on exported beer.—A domestic producer that exports beer may recover the tax (receive a "drawback") found to have been paid on the exported beer upon the "submission of such evidence, records and certificates indicating exportation" required by regulations.

Imported beer transferred in bulk to brewery and imported wine transferred in bulk to wineries.—Imported beer and wine are subject to tax when removed from customs custody.

House Bill

Imported distilled spirits returned to plant.—Refunds or credits of the tax are available for imported bottled spirits that are returned to distilled spirits plants.

Cancellation of export bonds.—The certification requirements are relaxed to allow the bonds to be canceled if there is such proof of exportation as the Secretary may require.

Location of records of distilled spirits plant.—Records and reports are permitted to be maintained elsewhere other than on the plant premises

Transfers from brewery to distilled spirits plant.—Beer may be brought from any brewery for use in the production of spirits. Such beer is exempt from excise tax, subject to Treasury regulations.

Sign not required for wholesale dealers.—The requirement that a sign be posted is repealed.

Refund on returns of merchantable wine.—A refund or credit is available in the case of all domestic wine returned to bond, whether or not unmerchantable.

Increased sugar limits for certain wine.—Up to 60 percent sugar is permitted in any wine made from juice, such as cranberry or plum juice, with an acid content of 20 or more parts per thousand.

Beer withdrawn for embassy use.—Subject to Treasury's regulatory authority, an exemption similar to that currently available for imported beer is provided for domestic beer.

Beer withdrawn for destruction.—An exemption from tax is added for removals for destruction, subject to Treasury regulations.

Drawback on exported beer.—The certification requirement is relaxed to allow a drawback of tax paid if there is such proof of exportation as the Secretary may by regulations require.

Imported beer transferred in bulk to brewery and imported wine transferred in bulk to wineries.—Subject to Treasury regulations, beer and wine imported in bulk may be withdrawn from customs custody and transferred in bulk to a brewery (beer) or a winery (wine) without payment of tax. The proprietor of the brewery to which the beer is transferred or of the winery to which the wine is transferred is liable for the tax imposed on the withdrawal from customs custody and the importer is relieved of liability.

Effective date.—The provision to repeal the requirement that wholesale liquor dealers post a sign outside their place of business takes effect on the date of enactment. The other provisions take effect on the first day of the calendar quarter that begins at least 90 days after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with a modification delaying the effective date of certain provisions from the first day of the calendar quarter that begins at least 90 days after the date of enactment to the first day of the quarter beginning at least 180 days after such date.

3. Authority for Internal Revenue Service to grant exemptions from excise tax registration requirements (sec. 1431 of the House bill and sec. 1231 of the Senate amendment)

Present Law

The Code exempts certain types of sales (e.g., sales for use in further manufacture, sales for export, and sales for use by a State or local government or a nonprofit educational organization) from excise taxes imposed on manufacturers and retailers. These exemptions generally apply only if the seller, the purchaser, and any person to whom the article is resold by the purchaser (the second purchaser) are registered with the Internal Revenue Service. The IRS can waive the registration requirement for the purchaser and second purchaser in some but not all cases.

House Bill

The IRS is authorized to waive the registration requirement for purchasers and second purchasers in all cases.

Effective date.—The provision applies to sales made pursuant to waivers issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Repeal of expired excise tax provisions (sec. 1432 of the House bill and sec. 1232 of the Senate amendment)

Present Law

The Code includes a provision relating to a temporary reduction in the tax on piggyback trailers sold before July 18, 1985, and provisions relating to the tax on the removal of hard minerals from the deep seabed before June 28, 1990.

An excise tax is imposed on the sale or use by the manufacturer or importer of certain ozone-depleting chemicals (sec. 4681). The amount of the tax generally is determined by multiplying the base tax amount applicable for the calendar year by an ozone-depleting factor assigned to each taxable chemical. The base tax amount was $5.80 per pound in 1996 and will increase by 45 cents per pound per year thereafter. The Code contains provisions for special rates of tax applicable to years before 1996 (e.g., sec. 4282 (g)(1), (2), (3), and (5)).

House Bill

These provisions are repealed, as "deadwood".

Effective date.—The provisions are effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Modifications to excise tax on certain arrows (sec. 1233 of the Senate amendment)

Present Law

An 11-percent manufacturer's excise tax is imposed on bows having a draw weight of more than 10 pounds and on arrows that either are greater than 18 inches in length or are suitable for use with a taxable bow. The tax is imposed on the manufacturer's sales price of the completed arrow.

House Bill

No provision.

Senate Amendment

The current excise tax on arrows tax is replaced with a manufacturer's excise tax on the four component parts of the arrow: shafts, points, nocks, and vanes. The tax rate is increased to 12.4 percent of the value of each of these four components to offset the reduction in aggregate value subjected to tax compared to present-law valuation of the completed arrow.

Effective date.—The provision is to be effective for arrow components sold after September 30, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Modifications to heavy highway vehicle retail excise tax (sec. 1234 of the Senate amendment)

Present Law

A 12-percent retail excise tax is imposed on certain heavy highway trucks and trailers, and on highway tractors. Small trucks (those with a gross vehicle weight not over 33,000 pounds) and lighter trailers (those with a gross vehicle weight not over 26,000 pounds) are exempt from the tax. The tax applies to the first retail sale of a new or remanufactured vehicle. The determination under present law of whether a particular modification to an existing vehicle constitutes remanufacture (taxable) or a repair (nontaxable) is factual and generally is based on whether the function of the vehicle is changed or, in the case of worn vehicles, whether the cost of the modification exceeds 75 percent of the value of the modified vehicle.

No tax is imposed on trucks, tractors, and trailers when they are sold for resale or long-term lease, if the purchaser is registered with the Treasury Department. In such cases, purchasers are liable for the tax when the vehicle is sold or leased. The tax is based on the sales price in the transaction to which it applies.

House Bill

No provision.

Senate Amendment

The Senate amendment makes two changes to the heavy vehicle excise tax:

(1) Clarification is provided that the 75-percent-of-value threshold applies in determining whether repairs to a wrecked vehicle constitute remanufacture; and

(2) The registration requirement currently applicable to certain sales of trucks, tractors, and trailers for resale is replaced with a certification requirement.

Effective date.—The provision is effective after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Treatment of skydiving flights as noncommercial aviation (sec. 1235 of the Senate amendment)

Present Law

Commercial passenger aviation, or air transportation for which a fare is charged, is subject to a 10-percent ad valorem excise tax for the Airport and Airway Trust Fund. Noncommercial aviation, or air transportation which is not “for hire,” is subject to a fuels tax for the Trust Fund. In the case of skydiving flights, questions have arisen as to when the flight is commercial aviation subject to the ticket tax and when it is noncommercial aviation subject to the fuels tax. In general, if instruction is offered, the flight is noncommercial aviation. Otherwise, the flight is treated as commercial aviation. Many skydiving flights carry both persons receiving instruction and others not receiving instruction.

House Bill

No provision.

Senate Amendment

The Senate amendment specifies that flights which are exclusively dedicated to skydiving are taxed as noncommercial aviation flights, regardless of whether instruction is offered to any of the passengers.

Effective date.—The provision is effective for flights beginning after September 30, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

8. Eliminate double taxation of certain aviation fuels sold to producers by "fixed base operators" (sec. 1236 of the Senate amendment)

Present Law

Section 4091 imposes a tax on the sale of aviation fuel by any producer (defined to include a wholesale distributor). Fuel sold at many rural airports is sold by retail dealers who do not qualify as wholesale distributors. This fuel is purchased by the retailers tax-paid. In certain instances, fuel which has been purchased tax-paid by a retailer will be re-sold to a producer, e.g., to enable the producer to serve one of its customers at the airport. When this fuel is resold at retail by the producer, a second tax is imposed. The Code contains no provision allowing a refund of the first tax in such cases.

House Bill

No provision.

Senate Amendment

The Senate amendment permits a refund of the tax previously paid on aviation fuel when a registered producer acquires the fuel.

Effective date.—The provision is effective for fuel sold after September 30, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, with a clarification that the provision applies to tax-paid fuel purchased by registered producers after September 30, 1997.

B. Tax-Exempt Bond Provisions

Overview

Interest on State and local government bonds generally is excluded from gross income for purposes of the regular individual and corporate income taxes if the proceeds of the bonds are used to finance direct activities of these governmental units (Code sec. 103).

Unlike the interest on governmental bonds, described above, interest on private activity bonds generally is taxable. A private activity bond is a bond issued by a State or local governmental unit acting as a conduit to provide financing for private parties in a manner violating either (1) a private business use and payment test or (2) a private loan restriction. However, interest on private activity bonds is not taxable if (1) the financed activity is specified in the Code and (2) at least 95 percent of the net proceeds of the bond issue is used to finance the specified activity.

Issuers of State and local government bonds must satisfy numerous other requirements, including arbitrage restrictions (for all such bonds) and annual State volume limitations (for most private activity bonds) for the interest on these bonds to be excluded from gross income.

1. Repeal of $100,000 limitation on unspent proceeds under 1-year exception from rebate (sec. 1441 of the House bill and sec. 1241 of the Senate amendment)

Present Law

Subject to limited exceptions, arbitrage profits from investing bond proceeds in investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government. No rebate is required if the gross proceeds of an issue are spent for the governmental purpose of the borrowing within six months after issuance.

This six-month exception is deemed to be satisfied by issuers of governmental bonds (other than tax and revenue anticipation notes) and qualified 501(c)(3) bonds if (1) all proceeds other than an amount not exceeding the lesser of 5 percent or $100,000 are so spent within six months and (2) the remaining proceeds are spent within one year after the bonds are issued.

House Bill

Under the House bill, the $100,000 limit on proceeds that may remain unspent after six months for certain governmental and qualified 501(c)(3) bonds otherwise exempt from the rebate requirement is deleted. Thus, if at least 95 percent of the proceeds of these bonds is spent within six months after their issuance, and the remainder is spent within one year, the six-month exception is deemed to be satisfied.

Effective date.—The provision applies to bonds issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Exception from rebate for earnings on bona fide debt service fund under construction bond rules (sec. 1442 of the House bill and sec. 1242 of the Senate amendment)

Present Law

In general, arbitrage profits from investing bond proceeds in investments unrelated to the governmental purpose of the borrowing must be rebated to the Federal Government. An exception is provided for certain construction bond issues if the bonds are governmental bonds, qualified 501(c)(3) bonds, or exempt-facility private activity bonds for governmentally-owned property.

This exception is satisfied only if the available construction proceeds of the issue are spent at minimum specified rates during the 24-month period after the bonds are issued. The exception does not apply to bond proceeds invested after the 24-month expenditure period as part of a reasonably required reserve or replacement fund, a bona fide debt service fund, or to certain other investments (e.g., sinking funds). Issuers of these construction bonds also may elect to comply with a penalty regime in lieu of rebating arbitrage profits if they fail to satisfy the exception's spending requirements.

House Bill

The House bill exempts earnings on bond proceeds invested in bona fide debt service funds from the arbitrage rebate requirement and the penalty requirement of the 24-month exception if the spending requirements of that exception are otherwise satisfied.

Effective date.—The provision applies to bonds issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Repeal of debt service-based limitation on investment in certain nonpurpose investments (sec. 1443 of the House bill and sec. 1243 of the Senate amendment)

Present Law

Issuers of all tax-exempt bonds generally are subject to two sets of restrictions on investment of their bond proceeds to limit arbitrage profits. The first set requires that tax-exempt bond proceeds be invested at a yield that is not materially higher (generally defined as 0.125 percentage points) than the bond yield ("yield restrictions"). Exceptions are provided to this restriction for investments during any of several "temporary periods" pending use of the proceeds and, throughout the term of the issue, for proceeds invested as part of a reasonably required reserve or replacement fund or a "minor" portion of the issue proceeds.

Except for temporary periods and amounts held pending use to pay current debt service, present law also limits the amount of the proceeds of private activity bonds (other than qualified 501(c)(3) bonds) that may be invested at materially higher yields at any time during a bond year to 150 percent of the debt service for that bond year. This restriction affects primarily investments in reasonably required reserve or replacement funds. Present law further restricts the amount of proceeds from the sale of bonds that may be invested in these reserve funds to ten percent of such proceeds.

The second set of restrictions requires generally that all arbitrage profits earned on investments unrelated to the governmental purpose of the borrowing be rebated to the Federal Government ("arbitrage rebate"). Arbitrage profits include all earnings (in excess of bond yield) derived from the investment of bond proceeds (and subsequent earnings on any such earnings).

House Bill

The House bill repeals the 150-percent of debt service yield restriction.

Effective date.— The provision applies to bonds issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Repeal of expired provisions relating to student loan bonds (sec. 1444 of the House bill and sec. 1244 of the Senate amendment)

Present Law

Present law includes two special exceptions to the arbitrage rebate and pooled financing temporary period rules for certain qualified student loan bonds. These exceptions applied only to bonds issued before January 1, 1989.

House Bill

These special exceptions are deleted as "deadwood."

Effective date.—The provision applies to bonds issued after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Tax Court Procedures

1. Overpayment determinations of Tax Court (sec. 1451 of the House bill and sec. 1251 of the Senate amendment)

Present Law

The Tax Court may order the refund of an overpayment determined by the Court, plus interest, if the IRS fails to refund such overpayment and interest within 120 days after the Court's decision becomes final. Whether such an order is appealable is uncertain.

In addition, it is unclear whether the Tax Court has jurisdiction over the validity or merits of certain credits or offsets (e.g., providing for collection of student loans, child support, etc.) made by the IRS that reduce or eliminate the refund to which the taxpayer was otherwise entitled.

House Bill

The House bill clarifies that an order to refund an overpayment is appealable in the same manner as a decision of the Tax Court. The House bill also clarifies that the Tax Court does not have jurisdiction over the validity or merits of the credits or offsets that reduce or eliminate the refund to which the taxpayer was otherwise entitled.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Redetermination of interest pursuant to motion (sec. 1452 of the House bill and sec. 1252 of the Senate amendment)

Present Law

A taxpayer may seek a redetermination of interest after certain decisions of the Tax Court have become final by filing a petition with the Tax Court. It would be beneficial to taxpayers if a proceeding for a redetermination of interest supplemented the original deficiency action brought by the taxpayer to redetermine the deficiency determination of the IRS. A motion, rather than a petition, is a more appropriate pleading for relief in these cases.

House Bill

The House bill provides that a taxpayer must file a "motion" (rather than a "petition") to seek a redetermination of interest in the Tax Court. The House bill also clarifies that the Tax Court's jurisdiction to redetermine the amount of interest under section

7481(c) does not depend on whether the interest is underpayment interest or overpayment interest.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. In clarifying the Tax Court's jurisdiction over interest determinations, the conferees do not intend to limit any other remedies that taxpayers may currently have with respect to such determinations, including in particular refund proceedings relating solely to the amount of interest due.

3. Application of net worth requirement for awards of litigation costs (sec. 1453 of the House bill and sec. 1253 of the Senate amendment)

Present Law

Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding. A person who substantially prevails must meet certain net worth requirements to be eligible for an award of administrative or litigation costs. In general, only an individual whose net worth does not exceed $2,000,000 is eligible for an award, and only a corporation or partnership whose net worth does not exceed $7,000,000 is eligible for an award. (The net worth determination with respect to a partnership or S corporation applies to all actions that are in substance partnership actions or S corporation actions, including unified entity-level proceedings under sections 6226 or 6228, that are nominally brought in the name of a partner or a shareholder.)

House Bill

The House bill provides that the net worth limitations currently applicable to individuals also apply to estates and trusts. The House bill also provides that individuals who file a joint tax return shall be treated as one individual for purposes of computing the net worth limitations. Consequently, the net worth of both spouses is aggregated for purposes of this computation. An exception to this rule is provided in the case of a spouse otherwise qualifying for innocent spouse relief.

Effective date.—The provision applies to proceedings commenced after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill with respect to estates and trusts. The Senate amendment provides that individuals who file a joint return are treated as separate individuals (resulting in a net worth limitation of $4,000,000 for individuals who file a joint return).

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with respect to estates and trusts. The conference agreement follows the Senate amendment with respect to individuals.

4. Tax Court jurisdiction for determination of employment status (sec. 1454 of the House bill and sec. 1254 of the Senate amendment)

Present Law

The Tax Court is a court of limited jurisdiction, established under Article I of the Constitution. The Tax Court only has the jurisdiction that is expressly conferred on it by statute (sec. 7442).

House Bill

The House bill provides that, in connection with the audit of any person, if there is an actual controversy involving a determination by the IRS as part of an examination that (1) one or more individuals performing services for that person are employees of that person or (2) that person is not entitled to relief under section 530 of the Revenue Act of 1978, the Tax Court would have jurisdiction to determine whether the IRS is correct. For example, one way the IRS could make the required determination is through a mechanism similar to the employment tax early referral procedures. [21]

The House bill provides for de novo review (rather than review of the administrative record). Assessment and collection of the tax would be suspended while the matter is pending in the Tax Court. Any determination by the Tax Court would have the force and effect of a decision of the Tax Court and would be reviewable as such; accordingly, it would be binding on the parties. Awards of costs and certain fees (pursuant to sec. 7430) would be available to eligible taxpayers with respect to Tax Court determinations pursuant to this proposal. The House bill also provides a number of procedural rules to incorporate this new jurisdiction within the existing procedures applicable in the Tax Court.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, with technical modifications.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with additional technical modifications.

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[21] See Announcement 96–13 and Announcement 97–52.

D. Other Provisions

1. Due date for first quarter estimated tax payments by private foundations (sec. 1461 of the House bill and sec. 1261 of the Senate amendment)

Present Law

Under section 4940, tax-exempt private foundations generally are required to pay an excise tax equal to two percent of their net investment income for the taxable year. Under section 6655(g)(3), private foundations are required to pay estimated tax with respect to their excise tax liability under section 4940 (as well as any unrelated business income tax (UBIT) liability under section 511).[22] Section 6655(c) provides that this estimated tax is payable in quarterly installments and that, for calendar-year foundations, the first quarterly installment is due on April 15th. Under section 6655(I), foundations with taxable years other than the calendar year must make their quarterly estimated tax payments no later than the dates in their fiscal years that correspond to the dates applicable to calendar-year foundations.

House Bill

The House bill amends section 6655(g)(3) to provide that a calendar-year foundation's first-quarter estimated tax payment is due on May 15th (which is the same day that its annual return, Form 990–PF, for the preceding year is due). As a result of the operation of present-law section 6655(I), fiscal-year foundations will be required to make their first-quarter estimated tax payment no later than the 15th day of the fifth month of their taxable year.

Effective date.—The provision applies to taxable years beginning after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Withholding of Commonwealth income taxes from the wages of Federal employees (sec. 1462 of the House bill and sec. 1262 of the Senate amendment)

Present Law

If State law provides generally for the withholding of State income taxes from the wages of employees in a State, the Secretary of the Treasury shall (upon the request of the State) enter into an agreement with the State providing for the withholding of State income taxes from the wages of Federal employees in the State. For

[22] Generally, the amount of the first quarter payment must be at least 25 percent of the lesser of (1) the preceding year's tax liability, as shown on the foundation's Form 990–PF, or (2) 95 percent of the foundation's current-year tax liability.

this purpose, a State is a State, territory, or possession of the United States. The Court of Appeals for the Federal Circuit recently held in *Romero* v. *United States* (38 F.3d 1204 (1994)) that Puerto Rico was not encompassed within this definition; consequently, the court invalidated an agreement between the Secretary of the Treasury and Puerto Rico that provided for the withholding of Puerto Rico income taxes from the wages of Federal employees.

House Bill

The House bill makes any Commonwealth eligible to enter into an agreement with the Secretary of the Treasury that would provide for income tax withholding from the wages of Federal employees.

Effective date.—The provision is effective January 1, 1998.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Certain notices disregarded under provision increasing interest rate on large corporate underpayments (sec. 1463 of the House bill and sec. 1263 of the Senate amendment)

Present Law

The interest rate on a large corporate underpayment of tax is the Federal short-term rate plus five percentage points. A large corporate underpayment is any underpayment by a subchapter C corporation of any tax imposed for any taxable period, if the amount of such underpayment for such period exceeds $100,000. The large corporate underpayment rate generally applies to periods beginning 30 days after the earlier of the date on which the first letter of proposed deficiency, a statutory notice of deficiency, or a nondeficiency letter or notice of assessment or proposed assessment is sent. For this purpose, a letter or notice is disregarded if the taxpayer makes a payment equal to the amount shown on the letter or notice within that 30 day period.

House Bill

The House bill provides that, for purposes of determining the period to which the large corporate underpayment rate applies, any letter or notice is disregarded if the amount of the deficiency, proposed deficiency, assessment, or proposed assessment set forth in the letter or notice is not greater than $100,000 (determined by not taking into account any interest, penalties, or additions to tax).

Effective date.—The provision is effective for purposes of determining interest for periods after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

XV. PENSION AND EMPLOYEE BENEFIT PROVISIONS

A. Miscellaneous Provisions Relating to Pensions and Other Benefits

1. Cash or deferred arrangements for irrigation and drainage entities (sec. 911 of the House bill)

Present Law

Under present law, taxable and tax-exempt employers may maintain qualified cash or deferred arrangements. State and local government organizations generally are prohibited from establishing qualified cash or deferred arrangements ("section 401(k) plans"). This prohibition does not apply to qualified cash or deferred arrangements adopted by a State or local government before May 6, 1986.

Mutual irrigation or ditch companies are exempt from tax if at least 85 percent of the income of the company consists of amounts collected from members for the sole purpose of meeting losses and expenses.

House Bill

Under the House bill, mutual irrigation or ditch companies and districts organized under the laws of a State as a municipal corporation for the purpose of irrigation, water conservation or drainage (or a national association of such organizations) are permitted to maintain qualified cash or deferred arrangements, even if the company or district is a State or local government organization.

Effective date.—The provision is effective with respect to years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Permanent moratorium on application of nondiscrimination rules to State and local governmental plans (sec. 912 of the House bill and sec. 1308 of the Senate amendment)

Present Law

Under present law, the rules applicable to governmental plans require that such plans satisfy certain nondiscrimination and minimum participation rules. In general, the rules require that a plan not discriminate in favor of highly compensated employees with regard to the contribution and benefits provided under the plan, participation in the plan, coverage under the plan, and compensation taken into account under the plan. Nondiscrimination rules apply to all governmental plans, qualified retirement plans (including cash or deferred arrangements (sec. 401(k) plans) in effect before May 6, 1986), and annuity plans (sec. 403(b) plans). Elective deferrals under section 401(k) plans are required to satisfy a special nondiscrimination test called the average deferral percentage ("ADP") test. Employer matching and after-tax employee contributions are subject to a similar test called the average contribution percentage ("ACP") test.

For purposes of satisfying the nondiscrimination rules, the Internal Revenue Service has issued several Notices which extended the effective date for compliance for governmental plans. Governmental plans will be required to comply with the nondiscrimination rules beginning with plan years beginning on or after the later of January 1, 1999, or 90 days after the opening of the first legislative session beginning on or after January 1, 1999, of the governing body with authority to amend the plan, if that body does not meet continuously. For plan years beginning before the extended effective date, governmental plans are deemed to satisfy the nondiscrimination requirements.

House Bill

The House bill provides that State and local governmental plans are exempt from the nondiscrimination and minimum participation rules.

Effective date.—Taxable years beginning on or after the date of enactment. A governmental plan is treated as satisfying the coverage and nondiscrimination tests for taxable years beginning before the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment and clarifies that the exemption from the nondiscrimination and participation rules includes exemption from the ACP and ADP tests. The conference agreement provides that a cash or deferred arrangement under a governmental plan is treated as a qualified cash or deferred arrangement even though the ADP test is not in fact satisfied. Thus, for example, elective contributions made by a government employer on behalf of an employee are not treated as distributed or made available to the employee (in accordance with section 402(e)(3) of the Code).

Effective date.—Same as the House bill and Senate amendment.

3. Treatment of certain disability payments to public safety employees (sec. 913 of the House bill and sec. 785 of the Senate amendment)

Present Law

Under present law, amounts received under a workmen's compensation act as compensation for personal injuries or sickness incurred in the course of employment are excluded from gross income. Compensation received under a workmen's compensation act by the survivors of a deceased employee also are excluded from gross income. Nonoccupational death and disability benefits are not excludable from income as workmen's compensation benefits.

House Bill

Under the House bill, certain payments made on behalf of full-time employees of any police or fire department organized and operated by a State (or any political subdivision, agency, or instrumentality thereof) are excludable from income. The House bill applies to payments made on account of heart disease or hypertension of the employee and that were received in 1989, 1990, 1991 pursuant to a State law as amended on May 19, 1992, which irrebuttably presumed that heart disease and hypertension are work-related illnesses, but only for employees separating from service before July 1, 1992. Claims for refund or credit for overpayment of tax resulting from the provision may be filed up to 1 year after the date of enactment, without regard to the otherwise applicable statute of limitations.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill, except that the provision applies to amounts payable under a State law (as in existence on July 1, 1992) which irrebuttably presumed that heart disease and hypertension are work-related illnesses, but only for employees separating from service before such date.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the House bill.

4. Portability of permissive service credit under governmental pension plans (sec. 914 of the House bill)

Present Law

Under present law, limits are imposed on the contributions and benefits under qualified pension plans (Code sec. 415). Certain special rules apply in the case of State and local governmental plans.

In the case of a defined contribution plan, the limit on annual additions is the lesser of $30,000 or 25 percent of compensation. Annual additions include employer contributions, as well as after-tax employee contributions. In the case of a defined benefit pension plan, the limit on the annual retirement benefit is the lesser of (1) 100 percent of compensation or (2) $125,000 (indexed for inflation). The 100 percent of compensation limitation does not apply in the case of State and local governmental pension plans.

Amounts contributed by employees to a State or local governmental plan are treated as made by the employer if the employer "picks up" the contribution.

House Bill

Under the House bill, in applying the defined benefit pension plan limit, the annual benefit under a State or local governmental plan includes the accrued benefit derived from contributions to purchase permissive service credit. Such contributions are not taken into account in determining annual additions.

Permissive service credit means credit for a period of service recognized by the governmental plan if the employee contributes to the plan an amount (as determined by the plan) which does not exceed the amount necessary to fund the accrued benefit attributable to such period of service.

The House bill does not affect the treatment of "pick up" contributions.

Effective date.—The provision is effective with respect to years beginning after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with modifications. Under the conference agreement, contributions by a participant in a State or local governmental plan to purchase permissive service credits are subject to one of two limits. Either (1) the accrued benefit derived from all contributions to purchase permissive service credit must be taken into account in determining whether the defined benefit pension plan limit is satisfied, or (2) all such contributions must be taken into account in determining whether the $30,000 limit on annual additions is met for the year (taking into account any other annual additions of the participant). Under the first alternative, a plan will not fail to satisfy the reduced defined benefit pension plan limit that applies in the case of early retirement due to the accrued benefit derived from the purchase of permissive service credits. These limits may be applied on a participant-by-participant basis. That is, contributions to purchase permissive service credits by all participants in the same plan do not have to satisfy the same limit.

Under the conference agreement, permissive service credit is defined as under the House bill. Thus, it is credit for a period of service that is recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) which does not exceed the amount necessary to fund the benefit attributable to the period of service and which is in addition to the regular employee contributions, if any, under the plan. Section 415 is violated if more than 5 years of permissive service credit is purchased for "nonqualified service". In addition, section 415 is violated if nonqualified service is taken into account for an employee who has less than 5 years of participation under the plan. Nonqualified service is service other than service (1) as a Federal, State, or local government employee, (2) as an employee of an association representing Federal, State or local government employees, (3) as an employee of an educational institution which provides elementary or secondary education, or (4) for military service. Service under (1), (2) or (3) is not qualified if it enables a participant to receive a retirement benefit for the same service under more than one plan.

The conference agreement provides that in the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State) any such repayment shall not be taken into account for purposes of section 415 and service credit obtained as a result of the repayment shall not be considered permissive service credit.

The provision is not intended to affect the application of "pick up" contributions to purchase permissive service credit or the treatment of pick up contributions under section 415. The provision does not apply to purchases of service credit for qualified military service under the rules relating to veterans' reemployment rights (sec. 414(u)).

Effective date.—In general, the conference agreement is effective with respect to contributions to purchase permissive service credits made in years beginning after December 31, 1997.

The conference agreement provides a transition rule for plans that provided for the purchase of permissive service credit prior to enactment of this Act. Under this rule, the defined contribution limits will not reduce the amount of permissive service credit of an eligible participant allowed under the terms of the plan as in effect on the date of enactment. For this purpose an eligible participant is an individual who first became a participant in the plan before the first plan year beginning after the last day of the calendar year in which the next regular session (following the date of the enactment of this Act) of the governing body with authority to amend the plan ends.

5. Gratuitous transfers for the benefit of employees (sec. 915 of the House bill)

Present Law

An employee stock ownership plan ("ESOP") is a qualified stock bonus plan or a combination stock bonus and money purchase pension plan under which employer securities are held for the benefit of employees.

A deduction is allowed for Federal estate tax purposes for transfers by a decedent to charitable, religious, scientific, etc. organizations. In the case of a transfer of a remainder interest to a charity, the remainder interest must be in a charitable remainder trust. A charitable remainder trust generally is a trust that is required to pay, no less often than annually, a fixed dollar amount (charitable remainder annuity trust) or a fixed percentage of the fair market value of the trust's assets determined at least annually (charitable remainder unitrust) to noncharitable beneficiaries, and the remainder of the trust (i.e., after termination of the annuity or unitrust amounts) to a charitable, religious, scientific, etc. organization.

House Bill

The House bill permits certain limited transfers of qualified employer securities by charitable remainder trusts to ESOPs without adversely affecting the status of the charitable remainder trusts. As a result, the bill provides that a qualified gratuitous transfer of employer securities to an ESOP is deductible from the gross estate of a decedent under Code section 2055 to the extent of the present value of the remainder interest. In addition, an ESOP will not fail to be a qualified plan because it complies with the requirements with respect to a qualified gratuitous transfer.

In order for a transfer of securities to be a qualified gratuitous transfer, a number of requirements must be satisfied, including the following: (1) the securities transferred to the ESOP must previously have passed from the decedent to a charitable remainder trust; (2) at the time of the transfer to the ESOP, family members of the decedent own (directly or indirectly) no more than 10 percent of the value of the outstanding stock of the company; (3) immediately after the transfer to the ESOP, the ESOP owns at least 60 percent of the value of outstanding stock of the company; and (4) the plan meets certain requirements. The provision applies in cases in which the ESOPs was in existence on August 1, 1996 and the decedent dies on or before December 31, 1998.

Effective date.—The provision is effective with respect to transfers to an ESOP after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

6. Treatment of certain transportation on noncommercially operated aircraft as a fringe benefit (sec. 916 of the House bill)

Present Law

Under present law, the value of an employer-provided flight taken for personal purposes is generally includible in income. However, under a special rule in regulations, the value of a personal flight is deemed to be zero (and, therefore, there is no income inclusion) if at least 50 percent of the regular passenger seating capacity of the aircraft is occupied by individuals whose flights are primarily for the employer's business (and therefore, excludable from income).

House Bill

Under the House bill, the value of air transportation for personal purposes is excludable from income if the flight is made in the ordinary course of the trade or business of an employer and the flight would have been made whether or not the employee was transported on the flight, and the employer incurs no substantial additional cost (including foregone revenue) in providing the flight to the employee.

Effective date.—The provision is effective for transportation services provided after December 31, 1997.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

7. Clarification of certain rules relating to ESOPs of S corporations (sec. 918 of the House bill and sec. 1309 of the Senate amendment)

Present Law

Under present law, an S corporation can have no more than 75 shareholders. For taxable years beginning after December 31, 1997, certain tax-exempt organizations, including employee stock ownership plans ("ESOPs") can be a shareholder of an S corporation.

ESOPs are generally required to make distributions in the form of employer securities. If the employer securities are not readily tradable, the employee has a right to require the employer to buy the securities. In the case of an employer whose bylaws or charter restricts ownership of substantially all employer securities to employees or a pension plan, the plan may provide that benefits are distributed in the form of cash. Such a plan may distribute employer securities, if the employee has a right to require the employer to purchase the securities.

ESOPs are subject to certain prohibited transaction rules under the Internal Revenue Code and title I of the Employee Retirement Income Security Act ("ERISA") which are designed to prohibit certain transactions between the plan and certain persons close to the plan. A number of statutory exceptions are provided to the prohibited transaction rules. These statutory exceptions do not apply to any transaction in which a plan (directly or indirectly) (1) lends any part of the assets of the plan to, (2) pays any compensation for personal services rendered to the plan to, or (3) acquires for the plan any property from or sells any property to a shareholder employee of an S corporation, a member of the family of such a shareholder employee, or a corporation controlled by the shareholder employee. An administrative exception from the prohibited transactions rules may be obtained from the Secretary of Labor, even if a statutory exception does not apply.

House Bill

The House bill provides that ESOPs of S corporations may distribute cash to plan participants as long as the employee has a right to require the employer to purchase employer securities (as under the present-law rules). In addition, the House bill extends the Code's statutory exceptions to certain prohibited transactions rules to shareholder employees of S corporations.

Effective date.—The provision is effective for taxable years beginning after December 31, 1997.

Senate Amendment

The Senate amendment is the same as the House bill with respect to the provision that permits ESOPs of S corporations to distribute stock in certain cases.

The Senate amendment provides that the sale of stock by a shareholder employee of an S corporation is not a prohibited transaction under the Code or ERISA.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment with respect to the provision permitting ESOPs maintained by S corporations to distribute employer securities in certain circumstances.

The conference agreement follows the Senate amendment with respect to the provision relating to prohibited transaction rules, as modified. Under the conference agreement, the statutory exceptions do not fail to apply merely because a transaction involves the sale of employer securities to an ESOP maintained by an S corporation by a shareholder employee, a family member of the shareholder employee, or a corporation controlled by the shareholder employee. Thus, the statutory exemptions for such a transaction (including the exemption for a loan to the ESOP to acquire employer securities in connection with such a sale or a guarantee of such a loan) apply.

Effective date.—Same as the House bill and the Senate amendment.

8. Repeal application of UBIT to ESOPs of S corporations (sec. 716 of the Senate amendment)

Present Law

Under present law, for taxable years beginning after December 31, 1997, certain tax-exempt organizations, including employee stock ownership plans ("ESOPs") can be a shareholder of an S corporation. Items of income or loss of the S corporation will flow through to qualified tax-exempt shareholders as unrelated business taxable income ("UBTI"), regardless of the source of the income.

House Bill

No provision.

Senate Amendment

The Senate amendment repeals the provision treating items of income or loss of an S corporation as unrelated business taxable income in the case of an employee stock ownership plan that is an S corporation shareholder.

Effective date.—Taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, and clarifies that the repeal of the provision treating items of income or loss of an S corporation as unrelated business taxable income applies only with respect to employer securities held by an employee stock ownership plan (as defined in section 4975(e)(7) of the Code) maintained by an S corporation.

9. Treatment of multiemployer plans under section 415 (sec. 711 of the Senate amendment)

Present Law

Present law imposes limits on contributions and benefits under qualified plans based on the type of plan. In the case of defined benefit pension plans, the limit on the annual retirement benefit is the lesser of (1) 100 percent of compensation or (2) $125,000 (indexed for inflation).

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the application of the 100 percent of compensation limitation for multiemployer defined benefit pension plans. Such plans would only be subject to the dollar limitation.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment.

10. Modification of partial termination rules (sec. 712 of the Senate amendment)

Present Law

Under the Internal Revenue Code, pension plan benefits are required to become fully vested upon termination or partial termination of the plan. The plan document is required to contain a provision reflecting this rule. Under section 552 of the Deficit Reduction Act of 1984 ("DEFRA"), for purposes of this rule, a partial termination is treated as not occurring if (1) the partial termination is a result of a decline in plan participation which occurs by reason of the completion of the Trans-Alaska Oil Pipeline construction project and occurred after December 31, 1975, and before January 1, 1980, with respect to participants employed in Alaska; (2) no discrimination occurred with respect to the partial termination; and (3) it is established to the satisfaction of the Secretary of the Treasury that the benefits of the provision will not accrue to the employers under the plan.

House Bill

No provision.

Senate Amendment

The Senate amendment clarifies that section 552 of DEFRA applies for the Code, any other provision of law, and any plan or trust provision.

Effective date.—The provision is effective as if included in section 552 of DEFRA.

Conference Agreement

The conference agreement does not include the Senate amendment.

11. Increase in full funding limit (sec. 713 of the Senate amendment)

Present Law

Under present law, defined benefit pension plans are subject to minimum funding requirements. In addition, there is a maximum limit on contributions that can be made to a plan, called the full funding limit. The full funding limit is the lesser of a plan's accrued liability and 150 percent of current liability. In general, current liability is all liabilities to plan participants and beneficiaries. Current liability represents benefits accrued to date, whereas the accrued liability full funding limit is based on projected benefits. Under IRS rules, amounts that cannot be contributed because of the current liability full funding limit are amortized over 10 years.

House Bill

No provision.

Senate Amendment

The Senate amendment increases the 150-percent of full funding limit as follows: 155 percent for plan years beginning in 1999 or 2000, 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.

In addition, under the provision, amounts that cannot be contributed due to the current liability full funding limit are amortized over 20 years. Amounts that could not be contributed because of such full funding limit and that have not been amortized as of the last day of the plan year beginning in 1998 are amortized over this 20-year period.

Effective date.—Plan years beginning after December 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that, with respect to amortization bases remaining at the end of the 1998 plan year, the 20-year amortization period is reduced by the number of years since the amortization base had been established. The conference agreement also clarifies that no amortization is required with respect to funding methods that do not provide for amortization bases.

12. Spousal consent required for distributions from section 401(k) plans (sec. 714 of the Senate amendment)

Present Law

Under present law, pension plans that provide automatic survivor benefits (i.e., joint and survivor annuities and preretirement survivor annuities) require spousal consent to the payment of a participant's benefit in a form other than a survivor annuity. A qualified cash or deferred arrangement (a "section 401(k) plan") is not subject to the automatic survivor benefit rules if the plan provides that the spouse of a participant is the beneficiary of the participant's entire account under the plan, the participant's benefit is not paid in the form of an annuity, and the participant's account does not include amounts transferred from another plan that was subject to the automatic survivor benefit rules. In general, spousal consent is not required for an involuntary cash-out of a participant's benefit or distributions made to satisfy the minimum distribution rules.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that written spousal consent is required for all distributions, including plan loans, from plans containing a qualified cash or deferred arrangement. As under present law, spousal consent is not required for an involuntary cash-out or a participant's benefit or for the payment of distributions required under the minimum distribution rules. If spousal consent is not obtained, the benefit must be distributed in equal periodic payments over the life (or life expectancy) of the participant, the lives (or life expectancies) of the participant and beneficiary, or over a period of 10 years or more. A plan which complies with the spousal consent requirement will not be treated as failing to satisfy the anti-cutback rules related to optional forms of benefit.

Effective date.—The provision is effective for plan years beginning after December 31, 1998.

Conference Agreement

The conference agreement does not include the Senate amendment.

13. Contributions on behalf of a minister to a church plan (sec. 715 of the Senate amendment)

Present Law

Under present law, contributions made to retirement plans by ministers who are self-employed are deductible to the extent such contributions do not exceed certain limitations applicable to retirement plans. These limitations include the limit on elective deferrals, the exclusion allowance, and the limit on annual additions to a retirement plan.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that in the case of a contribution made on behalf of a minister who is self-employed to a church plan, the contribution is excludable from the income of the minister to the extent that the contribution would be excludable if the minister were an employee of a church and the contribution were made to the plan.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment. The provision does not alter present law under which amounts contributed for a minister in connection with section 403(b), either by the minister's actual employer or by any church or convention or association of churches that is treated as the minister's employer under section 414(e), are excluded from the minister's income, and amounts contributed in accordance with section 403(b) by the minister (whether the minister is an employee or is self employed) are deductible by the minister as provided in section 404 taking into account the other special rules of section 414(e).

14. Exclusion of ministers from discrimination testing of certain non-church retirement plans (sec. 715 of the Senate amendment)

Present Law

Under present law, ministers who are employed by an organization other than a church are treated as if employed by the church and may participate in the retirement plan sponsored by the church. If the organization also sponsors a retirement plan, such plan does not have to include the ministers as employees for purposes of satisfying the nondiscrimination rules applicable to qualified plans provided the organization is not eligible to participate in the church plan.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that if a minister is employed by an organization other than a church and the organization is not otherwise participating in the church plan, then the minister does not have to be included as an employee under the retirement plan of the organization for purposes of the nondiscrimination rules.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

15. Diversification in section 401(k) plan investments (sec. 717 of the Senate amendment)

Present Law

The Employee Retirement Income Security Act of 1974, as amended ("ERISA") prohibits certain employee benefit plans from investing more than 10 percent of the plan's assets in the securities and real property of the employer who sponsors the plan. The 10-percent limitation does not apply to "eligible individual account plans" that specifically authorize such investments. Generally, eligible individual account plans are defined contribution plans, including plans containing a cash or deferred arrangement ("401(k) plans"). The assets of such plans may be invested in employer securities and real property without regard to the 10-percent limitation.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the term "eligible individual account plan" does not include the portion of a plan that consists of elective deferrals (and earnings on the elective deferrals) made under section 401(k) if elective deferrals equal to more than 1 percent of a participant's compensation are required to be invested in employer securities at the direction of a person other than the participant. Such portion of the plan is treated as a separate plan subject to the 10-percent limitation on investment in employer securities and real property.

The Senate amendment does not apply to an individual account plan if the value of the assets of all individual account plans maintained by the employer does not exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The Senate amendment does not apply to an employee stock ownership plan as defined in sections 409(a) and 4975(e)(7) of the Internal Revenue Code.

Effective date.—The provision is effective with respect to employer securities and employer real property acquired after the beginning of the first plan year beginning after the 90th day after the date of enactment. The provision does not apply to employer securities and real property acquired pursuant to a binding written contract to acquire such securities or real property in effect on the date of enactment and at all times thereafter.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications. The conference agreement clarifies that the provision applies if elective deferrals equal to more than 1 percent of an employee's eligible compensation are required to be invested in employer securities and employer real property. Eligible compensation is compensation that is eligible to be deferred. As under the Senate amendment, if the 1 percent threshold is exceeded, then the portion of the plan that consists of elective deferrals (and earnings thereon) is still treated as an individual account plan as long as elective deferrals (and earnings thereon) are not required to be invested in employer securities and employer real property.

The conference agreement provides that multiemployer plans are not taken into account in determining whether the value of the assets of all individual account plans maintained by the employer does not exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The conference agreement provides that the provision does not apply to an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

Effective date.—Under the conference agreement, the provision is effective with respect to elective deferrals in plan years beginning after December 31, 1998 (and earnings thereon). The provision does not apply with respect to earnings on elective deferrals for years beginning before January 1, 1999.

16. Removal of dollar limitation on benefit payments from a defined benefit plan for police and fire employees (sec. 786 of the Senate amendment)

Present Law

Under present law, limits are imposed on the contributions and benefits under qualified pension plans. Certain special rules apply in the case of State and local governmental plans.

In the case of a defined benefit pension plan, the limit on the annual retirement benefit is the lesser of (1) 100 percent of compensation or (2) $125,000 (for 1997, indexed for inflation). The 100 percent of compensation limitation does not apply in the case of State and local governmental pension plans. In general, the dollar limit is reduced if benefits begin before social security retirement age and increased if benefits begin after social security retirement age. In the case of State and local government plans, the dollar limit is not reduced unless benefits begin before age 62 and in any case is not less than $75,000, and the dollar limit is increased if benefits begin after age 65. In the case of certain police and fire department employees, the dollar limit cannot be reduced below

$50,000 (indexed), regardless of the age at which benefits commence.[1]

House Bill

No provision.

Senate Amendment

The dollar limit on defined benefit plans does not apply to individuals who receive the special rule for certain police and fire department employees under present law.

Effective date.—Years beginning after December 31, 1996.

Conference Agreement

The conference agreement follows the Senate amendment, with the clarification that the exception from the dollar limit for police and fire department employees only applies to the reduction for early retirement benefits. Thus, the defined benefit plan dollar limit continues to apply, but is not reduced in the case of early retirement. As under present law, the dollar limit is increased for such employees if benefits begin after age 65.

Effective date.—Same as the Senate amendment.

17. Church plan exception to prohibition on discrimination against individuals based on health status

Present Law

Under the Health Insurance Portability and Accountability Act ("HIPAA"), group health plans generally may not establish rules for eligibility based on any of the following factors relating to an individual or a dependent of the individual: (1) health status, (2) medical condition, (3) claims experience, (4) receipt of health care, (5) medical history, (6) genetic information, (7) evidence of insurability, or (8) disability. In addition, a group health plan may not charge an individual a greater premium based on any of such factors.

A excise tax is imposed on the failure of a group plan to satisfy the nondiscrimination rule. In general, the excise tax is imposed on the employer sponsoring the plan and is equal to $100 per day per individual as long as the plan is not in compliance.

House Bill

No provision.

Senate Amendment

No provision.

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[1] This special rule applies to participants (1) in a defined benefit plan of a State or local government plan, and (2) with respect to whom the period of service taken into account in determining the amount of the benefit under such plan includes at least 15 years of service of the participant as (a) a full-time employee of a police or fire department organized by a State or political subdivision to provide police protection, firefighting services, or emergency medical services or (b) as a member of the Armed Services of the United States.

Conference Agreement

The conference agreement provides that certain church plans are not treated as violating the nondiscrimination requirement merely because the plan requires evidence of good health in order for an individual to enroll in the plan for (1) individuals who are employees of employers with 10 or fewer and for self-employed individuals or (2) any individual who enrolls after the first 90 days of eligibility under the plan. The provision applies to a church plan for a year if the plan included such provisions requiring evidence of good health on July 15, 1997, and at all times thereafter before the beginning of the year.

Effective date.—The provision is effective as if included in HIPAA.

18. Newborns' and mothers' health protection; mental health parity

Present Law

The Newborns' and Mothers' Health Protection Act of 1996 amended the Employee Retirement Income Security Act ("ERISA") and the Public Health Service Act to impose certain requirements on group health plans with respect to coverage of newborns and mothers, including a requirement that a group health plan cannot restrict benefits for a hospital stay in connection with childbirth for the mother or newborn to less than 48 hours following a normal vaginal delivery or less than 96 hours following a cesarean section. These provisions are effective with respect to plan years beginning on or after January 1, 1998.

The Mental Health Parity Act of 1996 amended ERISA and the Public Health Service Act to provide that group health plans that provide both medical and surgical benefits and mental health benefits cannot impose limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. The provisions of the Mental Health Parity Act are effective with respect to plan years beginning on or after January 1, 1998, but do not apply to benefits for services furnished on or after September 30, 2001.

The Internal Revenue Code requires that group health plans meet certain requirements with respect to limitations on exclusions of preexisting conditions and that group health plans not discriminate against individuals based on health status. An excise tax of $100 per day during the period of noncompliance is imposed on the employer sponsoring the plan if the plan fails to meet these requirements. The maximum tax that can be imposed during a taxable year cannot exceed the lesser of 10 percent of the employer's group health plan expenses for the prior year or $500,000. No tax is imposed if the Secretary determines that the employer did not know, and exercising reasonable diligence would not have known, that the failure existed.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement incorporates into the Internal Revenue Code the provisions of the Newborns' and Mothers' Health Protection Act of 1996 and the Mental Health Parity Act of 1996 relating to group health plans. Failures to comply with such provisions are subject to the present-law excise tax applicable to failures to comply with present-law group health plan requirements.

Effective date.—The provisions are effective with respect to plan years beginning on or after January 1, 1998.

B. Pension Simplification Provisions

1. Matching contributions of self-employed individuals not treated as elective deferrals (sec. 1301 of the Senate amendment)

Present Law

A qualified cash or deferred arrangement (a "section 401(k) plan") is a type of tax-qualified pension plan under which employees can elect to make pre-tax contributions. An employee's annual elective contributions are subject to a dollar limit ($9,500 for 1997). Employers may make matching contributions based on employees' elective contributions. In the case of employees, such matching contributions are not subject to the $9,500 limit on elective contributions. Elective contributions are subject to a special nondiscrimination test called the average deferral percentage ("ADP") test. Matching contributions are subject to a similar nondiscrimination test called the average contributions percentage ("ACP") test. The employer may elect to treat certain matching contributions as elective contributions for purposes of the ACP test.

Under present law, matching contributions made for a self-employed individual are generally treated as additional elective contributions by the self-employed individual who receives the matching contribution. Accordingly, matching contributions for a self-employed individual are subject to the dollar limit on elective contributions (along with the individual's other elective deferrals) and are subject to the ACP test.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that matching contributions for self-employed individuals are treated the same as matching contributions for employees, i.e., they are not treated as elective contributions and are not subject to the elective contribution limits.

Effective date.—The provision is effective for years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, and clarifies that the provision does not apply to qualified matching contributions that are treated as elective contributions for purposes of satisfying the ADP test.

Effective date.—Same as the Senate amendment, except that the conference agreement provides that the provision is effective for years beginning after December 31, 1996, in the case of SIMPLE retirement plans.

2. Contributions to IRAs through payroll deductions (sec. 1302 of the Senate amendment)

Present Law

Under present law, employer involvement in the establishment or maintenance of individual retirement arrangements ("IRAs") of its employees can result in the employer being considered to maintain a retirement plan for purposes of title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), thus subjecting the employer to ERISA's fiduciary rules.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that an employer that facilitates IRA contributions by its employees by establishing a system under which employees, through employer payroll deductions, may make contributions to IRAs will not be considered to sponsor a retirement plan subject to ERISA. Under the system, employees would be required to provide their employer with a contribution certificate which establishes the IRA and specifies the contribution amount to be deducted from the employee's wages and remitted to the employee's IRA. As under present law, the amount contributed through payroll deduction would be includible in the employee's gross income and wages for employment tax purposes, and deductible by the employee in accordance with the rules relating to IRAs.

The provision does not apply to an employee employed by an employer who maintains a tax-qualified retirement plan.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement does not include the Senate amendment. The conference agreement provides that employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction system to help employees save for retirement by making payroll deduction contributions to their IRAs. The Secretary of Treasury is encouraged to continue his efforts to publicize the availability of these payroll deduction IRAs.

3. Plans not disqualified merely by accepting rollover contributions (sec. 1303 of the Senate amendment)

Present Law

Under present law, a qualified retirement plan that accepts rollover contributions from other plans will not be disqualified because the plan making the distribution is, in fact, not qualified at the time of the distribution, if, prior to accepting the rollover, the receiving plan reasonably concluded that the distributing plan was qualified. The receiving plan can reasonably conclude that the distributing plan was qualified if, for example, prior to accepting the rollover, the distributing plan provided a statement that the distributing plan had a favorable determination letter issued by the Internal Revenue Service ("IRS"). The receiving plan is not required to verify this information.

House Bill

No provision.

Senate Amendment

The Senate amendment clarifies the circumstances under which a qualified plan could accept rollover contributions without jeopardizing its qualified status. Under the provision, if the trustee of the plan making the distribution verifies that the distributing plan is intended to be a qualified plan, the plan receiving the rollover will not be disqualified if the distributing plan was not in fact a qualified plan.

Effective date.—The Senate amendment is effective for rollover contributions made after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment, as modified. Under the conference agreement, the Secretary of the Treasury is directed to clarify that, under its regulations protecting plans from disqualification because they receive invalid rollover contributions, it is not necessary for a distributing plan to have a determination letter in order for the administrator of the receiving plan to reasonably conclude that a contribution is a valid rollover.

4. Modification of prohibition on assignment or alienation (sec. 1304 of the Senate amendment)

Present Law

Under present law, amounts held in a qualified retirement plan for the benefit of a participant are not, except in very limited circumstances, assignable or available to personal creditors of the participant. A plan may permit a participant, at such time as benefits under the plan are in pay status, to make a voluntary revocable assignment of an amount not in excess of 10-percent of any benefit payment, provided the purpose is not to defray plan administration costs. In addition, a plan may comply with a qualified domestic relations order issued by a state court requiring benefit payments to former spouses or other "alternate payees" even if the participant is not in pay status.

There is no specific exception from the Employee Retirement Income Security Act of 1974, as amended ("ERISA") or the Internal Revenue Code which would permit the offset of a participant's benefit against the amount owed to a plan by the participant as a result of a breach of fiduciary duty to the plan or criminality involving the plan. Courts have been divided in their interpretation of the prohibition on assignment or alienation in these cases. Some courts have ruled that there is no exception in ERISA for the offset of a participant's benefit to make a plan whole in the case of a fiduciary breach. Other courts have reached a different result and permitted an offset of a participant's benefit for breach of fiduciary duties.

House Bill

No provision.

Senate Amendment

The Senate amendment permits a participant's benefit in a qualified plan to be reduced to satisfy liabilities of the participant to the plan due to (1) the participant is being convicted of committing a crime involving the plan, (2) a civil judgment (or consent order or decree) entered by a court in an action brought in connection with a violation of the fiduciary provisions of title I of ERISA, or (3) a settlement agreement between the Secretary of Labor or the Pension Benefit Guaranty Corporation and the participant in connection with a violation of the fiduciary provisions of ERISA. The court order establishing such liability must require that the participant's benefit in the plan be applied to satisfy the liability. If the participant is married at the time his or her benefit under the plan is offset to satisfy the liability, spousal consent to such offset would be required unless the spouse is also required to pay an amount to the plan in the judgment, order, decree or settlement or the judgment, order, decree or settlement provides a 50-percent survivor annuity for the spouse.

Effective date.—The Senate amendment is effective for judgments, orders, and decrees issued, and settlement agreements entered into, on or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment. The conference agreement clarifies that an offset is includible in income on the date of the offset.

5. Elimination of paperwork burdens on plans (sec. 1305 of the Senate amendment)

Present Law

Under present law, employers are required to prepare summary plan descriptions of employee benefit plans ("SPDs"), and summaries of material modifications to such plans ("SMMs"). The SPDs and SMMs generally provide information concerning the benefits provided by the plan and the participants' rights and obligations under the plan. The SPDs and SMMs must be furnished to plan participants and beneficiaries and filed with the Secretary of Labor.

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the requirement that SPDs and SMMs be filed with the Secretary of Labor. Employers would be required to furnish these documents to the Secretary of Labor upon request. A civil penalty could be imposed by the Secretary of Labor on the plan administrator for failure to comply with such requests. The penalty would be up to $100 per day of failure, up to a maximum of $1,000 per request. No penalty would be imposed if the failure was due to matters reasonably outside the control of the plan administrator.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

6. Modification of section 403(b) exclusion allowance to conform to section 415 modifications (sec. 1306 of the Senate amendment)

Present Law

Under present law, annual contributions to a section 403(b) annuity cannot exceed the exclusion allowance. In general, the exclusion allowance for a taxable year is the excess, if any, of (1) 20 percent of the employee's includible compensation multiplied by his or her years of service, over (2) the aggregate employer contributions for an annuity excludable for any prior taxable years.

Alternatively, an employee may elect to have the exclusion allowance determined under the rules relating to tax-qualified defined contribution plans (sec. 415). Tax-qualified defined contributions plans are subject to limitations on annual additions. In addition, for years beginning before January 1, 2000, an overall limit applies if an employee is a participant in both a defined contribution plan and defined benefit plan of the same employer (sec. 415(e)).

House Bill

No provision.

Senate Amendment

The provision conforms the section 403(b) exclusion allowance to the section 415 limits by providing that includible compensation includes elective deferrals (and similar pre-tax contributions) of the employee.

The Secretary of the Treasury is directed to revise the regulations regarding the exclusion allowance to reflect the fact that the overall limit on benefits and contributions is repealed (sec. 415(e)). The revised regulations are to be effective for limitation years beginning after December 31, 1999.

Effective date.—The modification to the definition of includible compensation is effective for years beginning after December 31, 1997. The direction to the Secretary is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment, with the clarification that the revised Treasury regulations are to be effective for years (rather than limitation years) beginning after December 31, 1999. In addition, the conference agreement clarifies that the revised regulations are to relate to the election to have the exclusion allowance determined under section 415.

7. New technologies in retirement plans (sec. 1307 of the Senate amendment)

Present Law

Under present law, it is not clear if sponsors of employee benefit plans may use new technologies (telephonic response systems, computers, E-mail) to satisfy the various ERISA requirements for notice, election, consent, recordkeeping, and participant disclosure.

House Bill

No provision.

Senate Amendment

The Senate amendment directs the Secretaries of the Treasury and Labor to issue guidance facilitating the use of new technology for plan purposes. The guidance is to be designed to (1) interpret the notice, election, consent, disclosure, and time requirements (and related recordkeeping requirements) under the Internal Revenue Code of 1986 ("IRC") and the Employee Retirement Income Security Act of 1974, as amended ("ERISA") relating to retirement plans as applied to the use of new technologies by plan sponsors and administrators while maintaining the protection of the rights of participants and beneficiaries, and (2) clarify the extent to which writing requirements under the IRC shall be interpreted to permit paperless transactions.

Effective date.—The provision is effective on the date of enactment and requires that the guidance be issued not later than December 31, 1998.

Conference Agreement

The conference agreement follows the Senate amendment.

8. Modification of 10-percent tax on nondeductible contributions (sec. 1310 of the Senate amendment)

Present Law

Under present law, if an employer sponsors both a defined benefit plan and a defined contribution plan that covers some of the same employees, the total deduction for all plans for a plan year is generally limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit plan for the year.

A 10-percent nondeductible excise tax is imposed on contributions that are not deductible. This excise tax does not apply to contributions to one or more defined contribution plans that are nondeductible because they exceed the combined plan deduction limit to the extent such contributions do not exceed 6 percent of compensation in the year for which the contribution is made.

House Bill

No provision.

Senate Amendment

The Senate amendment adds an additional exception to the 10-percent excise tax on nondeductible contributions. Under the provision, the excise tax does not apply to contributions to one or more defined contribution plans that are not deductible because they exceed the combined plan deduction limit to the extent such contributions do not exceed the amount of the employer's matching contributions plus the elective deferral contributions to a section 401(k) plan.

Effective date.—The provision is effective with respect to taxable years beginning after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

9. Modify funding requirements for certain plans (sec. 1311 of the Senate amendment)

Present Law

Under present law, defined benefit pension plans are required to meet certain minimum funding rules. Underfunded plans are required to satisfy certain faster funding requirements. In general, these additional requirements do not apply in the case of plans with a funded current liability percentage of at least 90 percent.

The Pension Benefit Guaranty Corporation ("PBGC") insures benefits under most defined benefit pension plans in the event the plan is terminated with insufficient assets to pay for plan benefits. The PBGC is funded in part by a flat-rate premium per plan participant, and a variable rate premium based on plan underfunding.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the minimum funding requirements in the case of certain plans. The provision applies in the case of plans that (1) were not required to pay a variable rate PBGC premium for the plan year beginning in 1996, (2) do not, in plan years beginning after 1995 and before 2009, merge with another plan (other than a plan sponsored by an employer that was a member of the controlled group of the employer in 1996), and (3) are sponsored by a company that is engaged primarily in the interurban or interstate passenger bus service.

The provision treats a plan to which it applies as having a funded current liability percentage of at least 90 percent for plan years beginning after 1996 and before 2005. For plan years beginning after 2004, the funded current liability percentage will be deemed to be at least 90 percent if the actual funded current liability percentage is at least at certain specified levels.

The relief from the minimum funding requirements applies for the plan year beginning in 2005, 2006, 2007, and 2008 only if contributions to the plan equal at least the expected increase in current liability due to benefits accruing during the plan year.

Effective date.—The provision is effective with respect to contributions due after December 31, 1997.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.—The provision is effective with respect to plan years beginning after December 31, 1996.

10. Date for adoption of plan amendments

Present Law

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

House Bill

No provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement provides that any amendments to a plan or annuity contract required to be made by the Act are not required to be made before the first day of the first plan year beginning on or after January 1, 1999. In the case of a governmental plan, the date for amendments is extended to the first plan year beginning on or after January 1, 2001. The conference agreement also provides that if an amendment is made pursuant to the Act (whether or not the amendment is required) before the date for required plan amendments, the plan or contract is operated in a manner consistent with the amendment during a period and the amendment is effective retroactively to such period (1) the plan or contract will not fail to be treated as operated in accordance with its terms for such period merely because it is operated in a manner consistent with the amendment, and (2) the plan will not fail to meet the anti-cutback provisions applicable to qualified retirement plans by reason of such a plan amendment.

XVI. SENSE OF THE SENATE RESOLUTIONS

A. Sense of the Senate Regarding Reform of the Internal Revenue Code of 1986 (sec. 780 of the Senate amendment)

Present Law

The Federal Government imposes an individual income tax, a corporate income tax, a payroll tax collected from both employees and employers, certain excise taxes, and transfer taxes on certain transfers of wealth by gift or from an estate.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a Sense of the Senate resolution that the Internal Revenue Code of 1986 needs broad-based reform, and that the President should submit a comprehensive proposal for reform.

Conference Agreement

The conference agreement does not include the Senate amendment.

B. Sense of the Senate Regarding Tax Treatment of Stock Options (sec. 781 of the Senate amendment)

Present Law

Under present law, an employer is generally entitled to a deduction with respect to stock options when the options are exercised by the employee. The deduction is generally the difference between the option price and the fair market value of the stock when the option is exercised.

House Bill

No provision.

Senate Amendment

The Senate amendment includes a Sense of the Senate resolution that finds that businesses can deduct the value of stock options as a business expense even though the options are not treated as an expense on the books of the business. It is the sense of the Senate that the Committee on Finance should hold hearings on the tax treatment of stock options.

Conference Agreement

The conference agreement does not include the Senate amendment.

C. Sense of the Senate Resolution Regarding Estate Taxes (sec. 782 of the Senate amendment)

Present Law

A gift tax is imposed on lifetime transfers by gift and an estate tax is imposed on transfers at death under a single unified graduated rate schedule that effectively begins at 37 percent and reaches 55 percent on cumulative taxable transfers over $3 million. A unified credit effectively exempts the first $600,000 in cumulative taxable transfers from estate and gift tax (sec. 2010).

An executor may elect 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 (up to a maximum reduction of $750,000). In addition, an executor may elect to pay the Federal estate tax attributable to a qualified closely-held business in installments over, at most, a 14-year period with a portion bearing 4-percent interest.

House Bill

No provision.

Senate Amendment

The Senate amendment provides a Sense of the Senate resolution that (1) estate tax relief provided by this bill is an important step that will enable more family-owned farms and small businesses to survive and continue to provide economic security and job creation in American communities and (2) Congress should eliminate the Federal estate tax liability for family-owned businesses by the end of 2002 on a deficit-neutral basis.

Conference Agreement

The conference agreement does not include the Senate amendment.

D. Sense of the Senate Regarding Who Should Benefit from Tax Cuts (sec. 791 of the Senate amendment)

Present Law

No provision.

House Bill

No provision.

Senate Amendment

The Senate amendment includes a Sense of the Senate resolution that only those who pay Federal income taxes should benefit from the tax reduction provisions of the Act.

Conference Agreement

The conference agreement does not include the Senate amendment.

E. Sense of the Senate Regarding Self-Employment Taxes of Limited Partners (sec. 734 of the Senate amendment)

Present Law

Under the Self-Employment Contributions Act, taxes are imposed on an individual's net earnings from self employment. A limited partner's net earnings from self employment include guaranteed payments made to the individual for services actually rendered and do not include a limited partner's distributive share of the income or loss of the partnership. The Department of the Treasury has issued proposed regulations defining a limited partner for this purpose. These regulations provide, among other things, that an individual is not a limited partner if the individual participates in the partnership business for more than 500 hours during the taxable year. The regulations are proposed to be effective beginning with the individual's first taxable year beginning on or after the date the regulations are published as final regulations in the Federal Register.

House Bill

No provision.

Senate Amendment

It is the Sense of the Senate that the Department of the Treasury should withdraw the proposed regulations defining limited partner, and that the Congress should determine the tax law governing self-employment income.

Conference Agreement

The conference agreement provides that any regulations relating to the definition of a limited partner for self-employment tax purposes shall not be issued or effective before July 1, 1998.

XVII. TECHNICAL CORRECTIONS PROVISIONS

House Bill

The House bill contains technical, clerical, and conforming amendments to the Small Business Job Protection Act of 1996, the Health Insurance Portability and Accountability Act of 1996, the Taxpayer Bill of Rights 2, and other recently enacted tax legislation.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment (1) does not contain the provision that defines the term "former reservations in Oklahoma" for purposes of section 168(j)(6) (relating to certain tax benefits provided with reference to activities occurring on Indian reservations) and (2) makes certain clarifications to the provisions relating to church plans included in the Small Business Job Protection Act of 1996.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. Thus, the conference agreement contains both the provision in the House bill relating to the definition of the term "former reservations in Oklahoma" and the provisions in the Senate amendment relating to church plans.

In addition, the conference agreement makes the following additions, modifications, and clarifications relating to technical correction provisions.

(1) The conference agreement amends section 205(c) of the Employee Retirement Income Security Act (as amended by the Small Business Job Protection Act of 1996) to clarify that the reference to "the Secretary" is to the Secretary of the Treasury.

(2) The conference agreement clarifies that, for purposes of the section 833 deduction, liabilities incurred during the taxable year under cost-plus contracts are added to claims incurred under section 833(b)(1)(A)(i). Similarly, for purposes of the section 833 deduction, expenses incurred during the taxable year in connection with cost-plus contracts are added to expenses incurred under section 833(b)(1)(A)(ii). The provision is effective as if included in the Tax Reform Act of 1986.

(3) The conference agreement provides that the technical correction provisions clarifying the phased reduction in luxury excise tax rates for automobiles will be effective for sales after the date of enactment of this Act.

(4) The conference agreement clarifies that, under the transition relief provided under the company-owned life insurance rule, the 4-out-of-7 rule and the single premium rule of present law are

not to apply solely by reason of a lapse occurring after October 13, 1995, by reason of no additional premiums being received under the contract.

XVIII. OTHER TAX PROVISION

A. Estimated Tax Requirements of Individuals (sec. 311(d) of the House bill)

Under present law, an individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax. An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. The 100 percent of last year's liability safe harbor is modified to be a 110 percent of last year's liability safe harbor for any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year.

House Bill

The House bill changes the 110 percent of last year's liability safe harbor to be a 109 percent of last year's liability safe harbor for taxable years beginning in 1997 and a 105 percent of last year's liability safe harbor for taxable years beginning in 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement changes the 110 percent of last year's liability safe harbor to be a 100 percent of last year's liability safe harbor for taxable years beginning in 1998, a 105 percent of last year's liability safe harbor for taxable years beginning in 1990, 2000, and 2001, and a 112 percent of last year's liability safe harbor for taxable years beginning in 2002. In addition, no estimated tax penalties will be imposed under section 6654 or 6655 for any period before January 1, 1998, for any payment the due date of which is before January 16, 1998, with respect to an underpayment to the extent the underpayment is created or increased by a provision of the Act.

XIX. TRADE PROVISIONS

A. Extension of Duty-Free Treatment Under the Generalized System of Preferences (sec. 971 of the House bill)

Present Law

Title V of the Trade Act of 1974, as amended (Generalized System of Preferences ("GSP")), grants authority to the President to provide duty-free treatment on imports of eligible articles from designated beneficiary developing countries, subject to specific conditions and limitations. To qualify for GSP privileges, each beneficiary country is subject to various mandatory and discretionary eligibility criteria. Import sensitive products are ineligible for GSP. The President's authority to grant GSP benefits expired on May 31, 1997.

House Bill

Under the House bill, the GSP program is reauthorized for two years, to expire on May 31, 1999. Refunds of any duty paid between May 31, 1997 and the date of enactment are provided upon request of the importer.

Effective date.—The provision is effective upon date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to extend the GSP reauthorization through June 30, 1998.

B. Temporary Suspension of Vessel Repair Duty (sec. 972 of the House bill)

Present Law

Section 466 of the Tariff Act of 1930 establishes a 50-percent duty on repairs made outside the United States to U.S. flag vessels.

House Bill

The current 50-percent duty on repairs to U.S. flag vessels made in countries that are signatories to the OECD Shipbuilding Agreement is suspended for a one-year period.

Effective date.—The provision is effective with respect to repair activities occurring for a one-year period beginning on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

C. United States-Caribbean Basin Trade Partnership Act (secs. 981-988 of the House bill)

Present Law

The Caribbean Basin Initiative ("CBI") program was established by the Caribbean Basin Economic Recovery Act ("CBERA"), which was enacted on August 5, 1983. This legislation authorized the President to grant duty-free treatment to the imports of eligible articles from designated countries in the Caribbean Basin region. Certain products (textiles, apparel, canned tuna, petroleum and petroleum products, footwear, handbags, luggage, flatgoods, work gloves, leather wearing apparel, watches and watch parts) were excluded under the statute from eligibility for duty-free treatment.

CBI trade benefits were made permanent in 1990.

House Bill

The House bill amends the Caribbean Basin Economic Recovery Act to provide additional temporary transitional trade benefits to products that are excluded from eligibility for duty-free treatment under CBI. These products are provided tariff and quota treatment which is comparable to treatment accorded to like articles imported from Mexico under the North American Free Trade Agreement ("NAFTA") subject to certain rule-of-origin and customs requirements and other limitations. The President must review periodically country adherence to eligibility criteria, and consult with beneficiary countries about free trade agreement negotiations.

Effective date.—The provision is effective for one year beginning January 1, 1998.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

XX. LIMITED TAX BENEFITS SUBJECT TO THE LINE ITEM VETO ACT

The Line Item Veto Act amended the Congressional Budget and Impoundment Act of 1974 to grant the President the limited authority to cancel specific dollar amounts of discretionary budget authority, certain new direct spending, and limited tax benefits. The Line Item Veto Act provides that the Joint Committee on Taxation is required to examine any revenue or reconciliation bill or joint resolution that amends the Internal Revenue Code of 1986 prior to its filing by a conference committee in order to determine whether or not the bill or joint resolution contains any limited tax benefits and to provide a statement to the conference committee that either (1) identifies each limited tax benefit contained in the bill or resolution, or (2) states that the bill or resolution contains no limited tax benefits. The conferees determine whether or not to include the Joint Committee's statement in the conference report. If the conference report includes the information from the Joint Committee on Taxation identifying provisions that are limited tax benefits, then the President may cancel one or more of those, but only those, provisions that have been identified. If such a conference report contains a statement from the Joint Committee on Taxation that none of the provisions in the conference report are limited tax benefits, then the President has no authority to cancel any of the specific tax provisions, because there are no tax provisions that are eligible for cancellation under the Line Item Veto Act.

The conference report contains a list of provisions that have been identified by the Joint Committee on Taxation as limited tax benefits within the meaning of the Line Item Veto Act. These provisions are listed below

(1) Sec. 101(c) (relating to high risk pools permitted to cover dependents of high risk individuals)

(2) Sec. 222 (relating to limitation on qualified 501(c)(3) bonds other than hospital bonds)

(3) Sec. 224 (relating to contributions of computer technology and equipment for elementary or secondary school purposes)

(4) Sec. 312(a) (relating to treatment of remainder interests for purposes of provision relating to gain from sale of principal residence)

(5) Sec. 501(b) (relating to indexing of alternative valuation of certain farm, etc., real property)

(6) Sec. 504 (relating to extension of treatment of certain rents under section 2032A to lineal descendants)

(7) Sec. 505 (relating to clarification of judicial review of eligibility for extension of time for payment of estate tax)

(8) Sec. 508 (relating to treatment of land subject to qualified conservation easement)

(9) Sec. 511 (relating to expansion of exception from generation-skipping transfer tax for transfers to individuals with deceased parents)

(10) Sec. 601 (relating to the research tax credit)

(11) Sec. 602 (relating to contributions of stock to private foundations)

(12) Sec. 603 (relating to the work opportunity tax credit)

(13) Sec. 604 (relating to orphan drug tax credit)

(14) Sec. 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create sections 1400 and 1400A (relating to tax-exempt economic development bonds)

(15) Sec. 701 (relating to incentives for revitalization of the District of Columbia) to the extent it amends the Internal Revenue Code of 1986 to create section 1400C (relating to first-time homebuyer credit for District of Columbia)

(16) Sec. 801 (relating to incentives for employing long-term family assistance recipients)

(17) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine containing pertussis bacteria, extracted or partial cell bacteria, or specific pertussis antigens

(18) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against measles

(19) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against mumps

(20) Sec. 904(b) (relating to uniform rate of tax on vaccines) as it relates to any vaccine against rubella

(21) Sec. 905 (relating to operators of multiple retail gasoline outlets treated as wholesale distributors for refund purposes)

(22) Sec. 906 (relating to exemption of electric and other clean-fuel motor vehicles from luxury automobile classification)

(23) Sec. 907(a) (relating to rate of tax on liquified natural gas determined on basis of BTU equivalency with gasoline)

(24) Sec. 907(b) (relating to rate of tax on methanol from natural gas determined on basis of BTU equivalency with gasoline)

(25) Sec. 908 (relating to modification of tax treatment of hard cider)

(26) Sec. 914 (relating to mortgage financing for residences located in disaster areas)

(27) Sec. 962 (relating to assignment of workmen's compensation liability eligible for exclusion relating to personal injury liability assignments)

(28) Sec. 963 (relating to tax-exempt status for certain State worker's compensation act companies)

(29) Sec. 967 (relating to additional advance refunding of certain Virgin Island bonds)

(30) Sec. 968 (relating to nonrecognition of gain on sale of stock to certain farmers' cooperatives)

(31) Sec. 971 (relating to exemption of the incremental cost of a clean fuel vehicle from the limits on depreciation for vehicles)

(32) Sec. 974 (relating to clarification of treatment of certain receivables purchased by cooperative hospital service organizations)

(33) Sec. 975 (relating to deduction in computing adjusted gross income for expenses in connection with service performed by

certain officials) with respect to taxable years beginning before 1991

(34) Sec. 977 (relating to elective carryback of existing carryovers of National Railroad Passenger Corporation)

(35) Sec. 1005(b)(2)(B) (relating to transition rule for instruments described in a ruling request submitted to the Internal Revenue Service on or before June 8, 1997)

(36) Sec. 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a public announcement

(37) Sec. 1005(b)(2)(C) (relating to transition rule for instruments described on or before June 8, 1997, in a public announcement or in a filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission

(38) Sec. 1011(d)(2)(B) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on May 3, 1995)

(39) Sec. 1011(d)(3) (relating to transition rule for distributions made pursuant to the terms of a tender offer outstanding on September 13, 1995)

(40) Sec. 1012(d)(3)(B) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a ruling request submitted to the Internal Revenue Service on or before April 16, 1997)

(41) Sec. 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a public announcement

(42) Sec. 1012(d)(3)(C) (relating to transition rule for distributions pursuant to an acquisition described in section 355(e)(2)(A)(ii) of the Internal Revenue Code of 1986 described in a public announcement or filing with the Securities and Exchange Commission) as it relates to a filing with the Securities and Exchange Commission

(43) Sec. 1013(d)(2)(B) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a ruling request submitted to the Internal Revenue Service submitted on or before June 8, 1997)

(44) Sec. 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement

(45) Sec. 1013(d)(2)(C) (relating to transition rule for distributions or acquisitions after June 8, 1997, described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission

(46) Sec. 1014(f)(2)(B) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a rul-

ing request submitted to the Internal Revenue Service on or before June 8, 1997)

(47) Sec. 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a public announcement

(48) Sec. 1014(f)(2)(C) (relating to transition rule for any transaction after June 8, 1997, if such transaction is described in a public announcement or filing with the Securities and Exchange Commission on or before June 8, 1997) as it relates to a filing with the Securities and Exchange Commission

(49) Sec. 1042(b) (relating to special rules for provision terminating certain exceptions from rules relating to exempt organizations which provide commercial-type insurance)

(50) Sec. 1081(a) (relating to termination of suspense accounts for family corporations required to use accrual accounting) as it relates to the repeal of Internal Revenue Code section 447(i)(3)

(51) Sec. 1089(b)(3) (relating to reformations)

(52) Sec. 1089(b)(5)(B)(i) (relating to persons under a mental disability)

(53) Sec.1171 (relating to treatment of computer software as FSC export property)

(54) Sec. 1175 (relating to exemption for active financing income)

(55) Sec. 1204 (relating to travel expenses of Federal employees doing criminal investigations)

(56) Sec. 1236 (relating to extension of time for filing a request for administrative adjustment)

(57) Sec. 1243 (relating to special rules for administrative adjustment request with respect to bad debts or worthless securities)

(58) Sec. 1251 (relating to clarification on limitation on maximum number of shareholders)

(59) Sec. 1253 (relating to attribution rules applicable to tenant ownership)

(60) Sec. 1256 relating to modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT years)

(61) Sec. 1257 (relating to treatment of foreclosure property)

(62) Sec. 1261 (relating to shared appreciation mortgages)

(63) Sec. 1302 (relating to clarification of waiver of certain rights of recovery)

(64) Sec. 1303 (relating to transitional rule under section 2056A)

(65) Sec. 1304 (relating to treatment for estate tax purposes of short-term obligations held by nonresident alien)

(66) Sec. 1311 (relating to clarification of treatment of survivor annuities under qualified terminable interest rules)

(67) Sec. 1312 (relating to treatment of qualified domestic trust rules of forms of ownership which are not trusts)

(68) Sec. 1313 (relating to opportunity to correct failures under section 2032A)

(69) Sec. 1414 (relating to fermented material from any brewery may be received at a distilled spirits plant)

(70) Sec. 1417 (relating to use of additional ameliorating material in certain wines)

(71) Sec. 1418 (relating to domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.)

(72) Sec. 1421 (relating to transfer to brewery of beer imported in bulk without payment of tax)

(73) Sec. 1422 (relating to transfer to bonded wine cellars of wine imported in bulk without payment of tax)

(74) Sec. 1506 (relating to clarification of certain rules relating to employee stock ownership plans of S corporations)

(75) Sec. 1507 (relating to modification of 10 percent tax for nondeductible contributions)

(76) Sec. 1523 (relating to repeal of application of unrelated business income tax to ESOPs)

(77) Sec. 1530 (relating to gratuitous transfers for the benefit of employees)

(78) Sec. 1532 (relating to special rules relating to church plans)

(79) Sec. 1604(c)(2) (relating to amendment related to Omnibus Budget Reconciliation Act of 1993)

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
I. Child and Dependent Care Tax Credits; Health Care for Children														
1. Tax credit for children under age 17 ($400 in 1998, and $500 thereafter; $75,000/$110,000 AGI phaseout for credit; nonrefundable for small families, refundable and limited to tax plus employee FICA minus EIC for large families [1 2].	1/1/98	....	−2,710	−18,119	−21,549	−21,401	−21,258	−20,901	−20,430	−19,702	−18,997	−18,317	−85,037	−183,384
2. Expand State high-risk pools to include spouses and children of high-risk individuals.	tyba 12/31/97	....	−1	−2	−2	−2	−2	−2	−2	−2	−2	−2	−8	−17
Subtotal of Child and Dependent Care Tax Credits; Health Care for Children.	....	....	**2,711**	**−18,121**	**−21,551**	**−21,403**	**−21,260**	**−20,903**	**−20,432**	**−19,704**	**−18,999**	**−18,319**	**−85,045**	**−183,401**
II. Education Tax Incentives														
A. Tax Benefits Relating to Education Expenses:														
1. Administration's HOPE credit for first 2 years; 100% credit for first $1,000 of eligible expenses; 50% credit for next $1,000; 20% credit for third and fourth year students for up to $5,000 of expenses; for years after 2002, expenses are increased to $10,000 (effective date of the 20% credit is 7/1/98); eligible expenses for HOPE credit are indexed in 2001; income limits for both credits indexed in 2001.	pma & tyba 12/31/97.	....	−2,083	−6,469	−7,393	−7,907	−7,707	−8,620	−8,754	−8,893	−9,035	−9,180	−31,559	−76,041

2. Expand State-sponsored prepaid tuition and State savings programs to include room and board[3].	tyba 12/31/97	....	−36	−107	−118	−130	−143	−157	−173	−190	−209	−230	−533	−1,491
3. Student loan interest deduction: $1,000 above-the-line deduction in 1998, $1,500 in 1999, $2,000 in 2000, $2,500 in 2001 and thereafter; phaseout $40,000–$55,000 single filers ($60,000–$75,000 joint filers); income limits indexed beginning in 2003.	poida 12/31/97	....	−18	−69	−122	−204	−277	−308	−326	−346	−368	−391	−690	−2,429
4. Penalty-free withdrawals from all IRAs for undergraduate, post-secondary vocational, and graduate education expenses.	tyba 12/31/97	....	−78	−201	−181	−175	−177	−179	−182	−184	−186	−189	−812	−1,732
5. Education IRA—permit contributions to Education IRA for a child under age 18; annual contributions limited to $500 per child; impose phaseout range of $95,000–$110,000 for single filers and $150,000–$160,000 for joint filers[4].	tyba 12/31/97	....	−156	−644	−912	−1,060	−1,126	−1,448	−1,752	−2,054	−2,360	−2,680	−3,899	−14,193
B. Other Education-Related Tax Provisions:														
1. Extend employer-provided education assistance for undergraduates through 5/31/00 [1].	tyba 12/31/96	....	−534	−369	−250	....	....	....	....	....	....	....	−1,153	−1,153
2. Repeal $150 million limit on tax-exempt section 501(c)(3) bonds for new capital expenditures.	1/1/98	....	−6	−45	−75	−89	−99	−106	−115	−125	−138	−162	−315	−962
3. Enhanced deduction for corporate contributions of computer technology and equipment for grades K–12; sunset after 3 years.	tyba 12/31/97	....	−46	−48	−77	−49	−5	−1	....	....	....	....	−225	−227
4. Raise small issuer arbitrage rebate exception for governmental bonds used to finance education facilities from $5 million to $10 million.	bia 12/31/97	....	−1	−4	−7	−11	−14	−27	−30	−33	−36	−38	−36	−199

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
5. Treatment of cancellation of certain student loans; with modification.	Da DOE	....	Negligible Revenue Effect											
6. Tax credit for holders of qualified education bonds (limited to $400 million per year in loans; 2-year sunset..	oia 12/31/97	....	−8	−27	−43	−47	−47	−47	−47	−47	−47	−47	−172	−408
Subtotal of Education Tax Incentives.	....	....	**−2,966**	**−7,983**	**−9,178**	**−9,672**	**−9,595**	**−10,893**	**−11,379**	**−11,872**	**−12,379**	**−12,917**	**−39,394**	**−98,835**

III. Savings and Investment Tax Incentives													
A. Individual Retirement Arrangements:													
1. IRA—Increase deductible IRA income limits by $10,000 for joint filers in 1998 ($5,000 for single filers in 1998) and by $1,000 per year through 2002; in 2003 increase to $40,000 for single filers and $60,000 for joint filers and by $5,000 per year thereafter until limits are $50,000–$60,000 for single filers and $80,000–$100,000 for joint filers (phase out range increases to $20,000 when lower limit reaches $100,000); penalty-free withdrawals for educational purposes and first-time home purchase only; create IRA PLUS; impose phase-out range of $95,000–$110,000 for single filers and $150,000–$160,000 for joint filers; impose $150,000–$160,000 income phase-out for spousal IRAs; provide that aggregate contributions to deductible and nondeductible retirement IRAs may not exceed $2,000.	tyba 12/31/97	....	−367	−345	86	−346	−860	−1,830	−3,292	−3,842	−4,424	−5,004	−1,832	−20,225

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
B. Capital Gains Provisions:														
1. Capital gains: (a) 20%/10% rate structure; (b) retain maximum 28% for collectibles; (c) section 1250 recapture at maximum of 25%; (d) symmetric AMT treatment; (e) exclusion for gain on personal residence (including remainder interests); (f) capital gains rate structure of 18%/8% for assets held more than 5 years after 2000, with mark-to-market in 2001; assets qualify for 8% in 2001 if held for 5 years regardless of when asset was acquired; (g) permit rollover of qualified small business stock if rolled over into another qualified small business stock within 60 days; and (h) retain 28%/15% rate structure for capital assets held more than 12 months but less than 18 months.	various	1,254	6,371	171	−2,954	−2,934	−1,785	−3,742	−3,981	−4,179	−4,424	−4,958	123	−21,161
Subtotal of Savings and Investment Tax Incentives.	....	**1,254**	**6,004**	**−174**	**−2,868**	**−3,280**	**−2,645**	**−5,572**	**−7,273**	**−8,021**	**−8,848**	**−9,962**	**−1,709**	**−41,386**
IV. Alternative Minimum Tax Provisions														
1. Exemption from alternative minimum tax for small corporations.	tyba 12/31/97	....	−97	−171	−131	−100	−77	−59	−45	−34	−26	−20	−577	−762
2. Conform AMT depreciation lives to the regular tax.	ppisa 12/31/98	....	....	−580	−1,653	−2,230	−2,358	−2,561	−2,622	−2,350	−2,044	−1,920	−6,821	−18,317
3. Reverse IRS position on AMT treatment of certain installment sales by farmers.	di tyba 12/31/87 ...	−8	−157	−158	−167	−164	−157	−148	22	22	21	21	−811	−872

Subtotal of Alternative Minimum Tax Provisions.	....	−8	−254	−909	−1,951	−2,494	−2,592	−2,768	−2,645	−2,362	−2,049	−1,919	−8,209	−19,951
V. Estate, Gift and Generation-Skipping Tax Provisions														
A. Estate and Gift Tax Provisions:														
1. Increase unified estate and gift tax credit to $625,000 in 1998; $650,000 in 1999; $675,000 in 2000 and 2001; $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005; $1 million in 2006 and thereafter; and index other provisions beginning in 1999; cap family owned business exclusion with unified credit at $1.3 million annually (exclude $675,000 in 1998, $650,000 in 1999, $625,000 in 2000, $625,000 in 2001, $600,000 in 2002 and 2003, $450,000 in 2004, $350,000 in 2005; $300,000 in 2006 and thereafter).	dda 12/31/97	....	....	−843	−1,259	−1,816	−2,013	−2,596	−2,997	−5,656	−7,279	−8,638	−5,931	−33,097
2. Reduce section 6601(j) interest rate to 2% for first $1 million of taxable closely-held business interests, remainder subject to tax at 45% of present-law interest rates, and all interest under section 6166 made nondeductible.	dda 12/31/97	....	....	−9	−17	−25	−33	−41	−47	−53	−58	−65	−84	−349
3. Provide up to $500,000 estate tax exclusion (phasein by $100,000 annually beginning in 1998) for treatment of land subject to a qualified conservation easement coordinated with exclusion of family farms (expanded treatment of land with severed mineral rights) and business relief used.	dda 12/31/97	....	....	−7	−15	−25	−35	−48	−51	−56	−60	−64	−82	−361

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
4. Extension of treatment of certain rents under section 2032A to lineal descendants.	roa 12/31/76		−25	−2	−2	−2	−2	−2	−2	−2	−2	−2	−33	−43
5. Clarification of judicial review of eligibility for extension of time for payment of estate tax.	dda DOE			−15	−15	−15	−15	−15	−15	−14	−12	−11	−60	−127
6. Gifts may not be revalued for estate tax purposes after expiration of statute of limitations.	gma DOE			−16	−18	−21	−26	−32	−38	−45	−53	−61	−81	−310
7. Repeal certain throwback rules applicable to domestic trusts; exclude pre-1984 multiple trusts from repeal.	tyba 12/31/97			−11	−11	−11	−11	−11	−11	−11	−11	−11	−44	−99
8. Estate tax relief for money going to ESOPs in existence on 8/1/96 and decedents dying before 1/1/99.	DOE		−8	−15									−23	−23
B. Generation-Skipping Tax Provision:														
1. Expand exception from generation-skipping transfer tax for transfers to individuals with deceased parents.	gsta 12/31/97			−4	−4	−4	−4	−4	−5	−5	−5	−6	−16	−41
Subtotal of Estate, Gift and Generation-Skipping Tax Provisions.			**−33**	**−922**	**−1341**	**−1919**	**−2139**	**−2749**	**−3166**	**−5842**	**−7480**	**−8858**	**−6354**	**−34450**
VI. Expiring Tax Provisions														
1. Research tax credit through 6/30/98.	6/1/97	−161	−820	−639	−294	−204	−123	−33					−2,241	−2,274
2. Contributions of appreciated stock to private foundations through 6/30/98.	6/1/97		−99	−9	−4								−112	−112
3. Extend a modified work opportunity tax credit through 6/30/98 [5]; include SSI recipients.	wpoifhma 9/30/97		−140	−131	−73	−28	−11	−2					−383	−385

4. Orphan drug tax credit (permanent)	6/1/97		−29	−28	−30	−32	−34	−35	−37	−39	−40	−42	−152	−346
Subtotal of Expiring Tax Provisions		**−161**	**−1,088**	**−807**	**−401**	**−264**	**−168**	**−70**	**−37**	**−39**	**−40**	**−42**	**−2,888**	**−3,117**
VII. District of Columbia Tax Incentives														
1. Designate existing D.C. enterprise community and census tracts with greater than 20% poverty (with revised residency requirement) as the D.C. Enterprise Zone, eligible for modified present-law empowerment zone incentives (20% wage credit, increased 179 expensing, and expanded tax-exempt financing); sunset 12/31/02.	1/1/98		−71	−110	−113	−118	−127	−45	3	2	(6)	−2	−539	−582
2. Provide 0% capital gains rate on enterprise zone business property in D.C. census tracts with greater than 10% poverty held for at least 5 years; sunset 12/31/02.	1/1/98		−1	−5	−12	−21	−33	−48	−85	−90	−99	−107	−73	−502
3. $5,000 tax credit for first-time homebuyer in D.C., with phaseout of $110,000–$130,000 for joint filers ($70,000–$90,000 for single filers), and sunset 12/31/00.	po/a DOE		−10	−21	−27	−16	(6)	(6)	(6)	(6)	(6)	(6)	−74	−74
Subtotal of District of Columbia Tax Incentives.			**−82**	**−136**	**−152**	**−155**	**−160**	**−93**	**−82**	**−88**	**−99**	**−109**	**−686**	**−1,158**
VIII. Welfare-to-Work Tax Credit														
Administration's welfare-to-work tax credit, as modified: (a) wage credit is 35% on first $10,000 of wages in the first year of employment, and 50% on $10,000 of wages in the second year of employment; (b) effective for hires made through 4/30/99.	**wpoifhma 12/31/97**		**−13**	**−31**	**−29**	**−15**	**−10**	**−4**	**−2**	**−1**			**−99**	**−106**

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
IX. Miscellaneous Provisions														
A. Excise Tax Provisions:														
1. Repeal excise tax on recreational motorboat diesel fuel.	1/1/98	....	−4	−5	−5	−1	−1	−1	−1	−1	−1	−1	−16	−22
2. Modify excise tax on imported halons.	DOE	([7])	([7])	([7])	([7])	([7])	([7])	([7])	([7])	([7])	([7])	([7])	1	1
3. Transfer the 4.3 cents/gallon transportation motor fuels tax on highway motor fuels to the Highway Trust Fund.	10/1/97	No Revenue Effect												
4. Modify excise tax deposit rules for gasoline and special motor fuels, diesel fuel and kerosene, aviation fuels, and air cargo taxes to suspend deposits due 8/1/98 to 9/30/98 until 10/5/98.	DOE	....	−6,359	6,359	....	....	....	....	....	....	....	....	....	....
5. Equalize the excise tax rates among alternative motor fuels except CNG.	DOE	−2	−15	−16	−16	−17	−18	−19	−20	−21	−22	−23	−82	−186
6. Treat certain gasoline retailers as wholesale distributors under gasoline tax refund rules.	DOE	Negligible Revenue Effect												
7. Reduce excise tax rate on draft cider to the small producer beer rate.	10/1/97	....	−1	−1	−1	−1	−1	−1	−1	−1	−1	−1	−3	−7
8. Require study on simplified collection of distilled spirits taxes.	....	No Revenue Effect												
9. Codify Bureau of Alcohol, Tobacco, and Firearms regulations on wine labeling; with modification.	DOE	No Revenue Effect												
10. Uniform excise tax on vaccines; add 3 new vaccines ($0.75 per dose).	10/1/97	....	−16	−15	−15	−15	−14	−14	−14	−14	−14	−14	−74	−146

B. Disaster Relief Provisions:														
1. Disaster losses—postponement of IRS deadlines and loss valuation; permit extension of statute of limitations.	aoty	Negligible Revenue Effect												
2. Modify tax treatment of livestock sold on account of certain weather-related conditions.	sea 12/31/96	....	−12	−2	−2	−2	−1	−1	−1	−1	−1	−1	−18	−23
3. Loosen mortgage revenue bond requirements in Presidentially declared disaster areas for 2 years; permit 2-year period to place mortgages.	[8]	....	−3	−7	−8	−8	−7	−6	−6	−5	−4	−4	−33	−58
4. Abatement of interest on underpayments by taxpayers in Presidentially declared disaster areas (1997 disaster areas only).	1/1/97	−5	....	....	....	....	....	....	....	....	....	....	−5	−5
C. Provisions Relating to Employment Taxes:														
1. Worker classification of securities brokers for income and employment tax purposes.	spa 12/31/97	Negligible Revenue Effect												
2. Impose moratorium on issuance of Treasury regulation relating to self-employment tax (SECA) through 6/30/98.	DOE	No Revenue Effect												
3. SECA for insurance agents	pa 12/31/97	Negligible Revenue Effect												
D. Provisions Relating to Small Businesses:														
1. Delay penalties for failure to make payments through EFTPS until after 6/30/98.	DOE	No Revenue Effect												
2. Definition of principal place of business for home office deduction.	tyba 12/31/98	....	....	−119	−244	−253	−263	−274	−285	−295	−306	−318	−880	−2,358

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
3. Increase deduction for health insurance expenses of self-employed individuals: 50% in 2000 and 2001, 60% in 2002, 80% in 2003 through 2005; 90% in 2006, and 100% in 2007 and thereafter.	tyba 12/31/96	....	....	....	−39	−120	−224	−605	−882	−601	−404	−604	−383	−3,479
E. Other Provisions:														
1. Shrinkage allowance for inventory account.	....	....	−7	−21	−23	−25	−27	−29	−31	−33	−35	−37	−103	−268
2. Include liability to pay compensation under workmen's compensation acts within rules relating to certain personal liability assignments.	cfa DOE	....	−1	−2	−5	−8	−12	−17	−23	−29	−32	−36	−27	−164
3. Clarify tax-exempt status of certain State workmen's compensation funds.	tyba 12/31/97	....	[6]	[6]	−1	−1	−1	−1	−1	−1	−1	−1	−2	−6
4. Allow grandfathered publicly traded partnerships to elect to pay a publicly traded partnership tax; with technical modifications.	tyba 12/31/97						Revenue Neutral							
5. Exclusion from UBTI for certain corporate sponsorship payments, with technical clarification.	psora 12/31/97						Negligible Revenue Effect							
6. Allow timeshare associations to elect to be taxed as homeowner associations at 32% rate and modify definition of property for timeshares.	tyba 12/31/96	....	−1	−1	−1	−1	−2	−2	−2	−2	−2	−2	−7	−17
7. Deferral of gain on sales of stock in farm product refining firms to farm coops which supply the firm with raw farm products for refining.	sea 12/31/97	....	−2	−68	−5	−5	−4	−4	−4	−4	−4	−4	−84	−104

8. No information reporting on sales of principal residences less than $250,000 or $500,000 (married filing joint return).	DOE	....	Negligible Revenue Effect										
9. Increase the business meals deduction to 80% in 5% increments every other year for persons subject to Federal hours of service limitation, with clarification of section 119 meals.	tyba 12/31/97	....	−8	−17	−27	−37	−49	−62	−76	−91	−108	−125	−138	−600
10. Provide an above-the-line deduction for certain State and local official's expenses.	1/1/87	....	−10	−4	−4	−4	−5	−5	−6	−6	−7	−7	−27	−58
11. Raise the charitable mileage rate from 12 cents/mile to 14 cents/mile; no indexing.	tyba 12/31/97	....	−8	−56	−58	−61	−64	−68	−71	−75	−78	−82	−247	−621
12. Expense "Brownfields" redevelopment costs in empowerment zones, enterprise communities and EPA demonstration sites; add census tracts with greater than 20% poverty, 3-year sunset.	(9)	....	−57	−132	−165	−63	(7)	2	9	17	19	18	−417	−352
13. Administration's proposal to add 20 urban empowerment zones with modified incentives (including interaction with Conference Brownfields proposal).	DOE	....	−82	−121	−121	−99	−79	−56	−44	−41	−38	−25	−502	−706
14. Designate 2 supplemental empowerment zones as regular empowerment zones, with present-law incentives (phaseout of wage credit beginning in 2004).	1/1/00	....	....	....	−38	−86	−92	−98	−78	−53	−26	−13	−215	−483
15. Exemption for incremental cost of clean-fuel vehicle from luxury tax and limits on depreciation.	DOE	(6)	−1	−1	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	−2	−2
16. Exclude from gross income certain survivor benefits attributable to a public safety officer who is killed in the line of duty.	(10)	....	(6)	−1	−1	−1	−1	−1	−1	−1	−2	−2	−4	−12

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
17. Suspend 100% net income limitation with respect to percentage depletion on oil and gas property for marginal producers for 2 years.	tyba DOE		−21	−35	−14								−70	−70
18. Allow refunding of certain tax-exempt Virgin Islands bonds.	bia DOE		−2	−4	−5	−5	−5	−3	−1	−3	−4	−4	−21	−37
19. Purchasing of receivables by tax-exempt hospital cooperative service organizations.	tyba 12/31/96	Negligible Revenue Effect												
20. Modification of empowerment zone and enterprise community criteria in the event of future designations of additional zones and communities.	DOE	No Revenue Effect												
21. 3-year income averaging for farmers.	tyba DOE ab 1/1/01.	−1	−10	−53	−54	−50							−168	−168
22. Prior year estimated tax safe harbor (100% in 1998, 105% in 1999 through 2001, and 112% in 2002).			−7,400	4,000			4,400	−1,000					1,000	
23. Montana simplified tax and wage reporting system (5-year demonstration).		No Revenue Effect												
24. National Passenger Rail (Amtrak) NOL provision.	DOE		−1,162	−1,162									−2,323	−2,323
SUBTOTAL OF MISCELLANEOUS PROVISIONS.		**−8**	**−15,182**	**8,516**	**−852**	**−863**	**3,530**	**−2,265**	**−1,539**	**−1,261**	**−1,071**	**−1,286**	**−4,850**	**−12,274**

X. Revenue-Increase Provisions														
A. Financial Products:														
1. Require recognition of gain on certain appreciated positions in personal property, with technical modifications.	csa 6/8/97	....	....	367	121	68	73	79	85	94	111	118	127	708	1,243
2. Gains or losses from certain terminations with respect to property; with technical modification and effective date with modifications.	30da DOE	....	....	15	27	25	25	25	25	25	25	25	25	117	242
3. Determination of original issue discount where pooled debt obligations subject to acceleration.	tyba DOE	....	....	76	275	358	319	283	100	105	109	114	118	1,311	1,857
4. Denial of interest deduction on certain debt instruments.	iia 6/8/97	....	....	5	16	29	43	55	62	63	64	65	67	148	469
B. Corporate Organizations and Reorganizations:														
1. Tax treatment of certain extraordinary dividends.	da 9/13/95	....	....	44	−93	−54	−10	45	77	81	89	95	101	−68	375
2. Require gain recognition on certain distributions of controlled corporation stock (with modifications for intragroup distributions); with binding contract modification.	da 4/16/97	....	....	301	243	216	187	158	130	101	73	46	10	1,105	1,465
3. Tax treatment of redemptions involving related corporations.	da/a 6/8/97	....	....	10	10	5	5	5	5	5	5	5	5	35	60
4. Modify holding period for dividends-received deduction with 2-year transition period.	droaa 30da DOE	...	....	11	13	15	16	16	16	17	17	17	18	71	156
C. Other Corporate Provisions:														
1. Registration and other provisions relating to confidential corporate tax shelters.	tsoaiTg	....	....	15	37	38	39	41	42	43	44	46	47	170	392
2. Certain preferred stock treated as "boot," with clarification.	ta 6/8/97	....	....	35	37	39	41	43	10	10	11	11	12	194	248
D. Administrative Provisions:														
1. Reporting of certain payments made to attorneys.	pma 12/31/97	....	....	....	3	3	3	3	3	4	4	4	4	12	31

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
2. Decrease of threshold for reporting payments to corporations performing services for Federal agencies.	rd 90da DOE	....	....	7	8	9	10	11	11	12	12	13	34	93
3. Extend disclosure of tax return information for administration of certain Veterans' programs [12].	dma 9/30/98	....	....	22	27	31	36	36	....	....	....	....	116	152
4. Modify levy exemption and provide continuous levy on certain payments.	lia DOE	....	332	327	256	213	157	117	102	86	82	78	1,285	1,750
5. Consistency requirement for returns of beneficiaries of estates and trusts.	rfa DOE	....	3	3	3	3	3	3	4	4	4	4	15	34
E. Excise Tax Provisions:														
1. Extend and modify Airport Trust Fund excise taxes:.														

a. Extend domestic air passenger ticket tax: reduce tax rate from 10% to 9% of ticket price and impose an additional tax of $1.00 per flight segment for 10/1/97 through 9/30/98; 8% and $2.00/segment for 10/1/98 through 9/30/99; and 7.5% after 9/30/99 with additional tax of $2.25/segment for 10/1/99 through 12/31/99, $2.50/segment in 2000, $2.75/segment in 2001, and $3.00/segment in 2002, and in years thereafter index the $3.00/segment tax to changes in the CPI (first indexing adjustment on 1/1/03).	10/1/97	....	4,633	4,859	5,031	5,433	5,870	6,275	6,684	7,117	7,580	8,059	25,826	61,542
b. Modify airline ticket tax deposit rule to suspend deposits due 8/15/97 to 9/30/97 until 10/10/97, and suspend deposits due 8/15/98 to 9/30/98 until 10/5/98.	DOE	−1,017	−199	1,216	....	....	....	....	....	....	....	....	....	....
c. Reduce air passenger ticket tax to 7.5% of ticket price (and omit segment tax) for flight segments to/from certain rural airports [13].	10/1/97	....	−26	−27	−26	−27	−27	−28	−30	−31	−32	−33	−133	−289

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
d. Extend international departure tax: increase tax from $6.00 to $12/passenger, tax arrivals at the same rate, and index the $12 tax to changes in the CPI (first indexing adjustment on 1/1/99), but retain present-law $6.00/passenger departure tax for domestic flights to/from Alaska and Hawaii, and index the $6.00 departure tax to changes in the CPI (first indexing adjustment on 1/1/99).	10/1/97	....	788	879	948	1,026	1,114	1,209	1,307	1,411	1,526	1,653	4,754	11,859
e. Impose 7.5% tax rate on cash payments to airlines for air travel under credit card and similar programs.	10/1/97	....	65	73	77	82	87	92	98	104	110	116	384	904
f. Extend current air cargo excise tax.	10/1/97	....	304	347	377	409	443	481	522	567	615	667	1,880	4,732
g. Extend current taxes on noncommercial aviation gasoline and noncommercial jet fuel.	10/1/97	....	84	87	89	91	93	95	97	99	102	104	446	943
h. Dedicate 4.3 cents/gallon of tax on aviation fuel to the Airport and Airway Trust Fund.	10/1/97	....						No Revenue Effect						
2. Tax kerosene in the same manner as diesel fuel; modify to address home heating in Alaska.	7/1/98	....	44	43	49	46	44	43	44	47	49	52	226	461
3. Reinstate LUST excise tax and extend through 3/31/05.	10/1/97	....	129	129	128	129	131	134	136	67	....	....	645	983

4. Apply 3% telephone excise tax to certain prepaid phone cards, with technical modification.	DOE	....	19	28	38	49	60	71	83	101	113	124	193	684
5. Replace truck excise tax deduction for tire value with tax credit for excise tax paid on tires.	Sa 12/31/97	....	66	94	96	97	99	101	102	105	108	110	452	979
F. Provisions Relating to Tax-Exempt Organizations:														
1. Modify control test and include attribution rules to determine UBIT consequences of certain payments from subsidiaries of tax-exempt organizations.	tyba 12/31/98 & tyba 2ya DOE.	....	(7)	(7)	(7)	3	5	5	4	4	4	4	8	29
2. Repeal 1986 Act grandfather rules for pension business of TIAA-CREF and Mutual of America.	tyba 12/31/97	....	(7)	82	116	124	128	133	140	149	160	174	450	1,208
G. Foreign Provisions:														
1. Inclusion of income from notional principal contracts and stock lending transactions under subpart F.	tyba DOE	....	9	20	21	21	21	21	22	22	22	23	92	202
2. Further restrict like-kind exchanges involving foreign personal property.	Ta dofca	....	4	8	11	13	15	17	19	21	23	25	51	156
3. Impose holding period requirement for claiming foreign tax credits with respect to dividends.	dpoaa 30da DOE ...	....	23	48	50	53	56	58	61	64	68	71	230	552
4. Limitation on treaty benefits for payments to hybrid entities.	DOE	....	1	1	1	1	1	1	1	1	1	1	5	10
5. Interest on underpayment reduced by foreign tax credit carryback.	ftpoa tyba DOE	....	8	10	2	1	1	1	1	1	1	1	22	27
6. Determination of period of limitations relating to foreign tax credits.	ftpoa tyba DOE	....	1	2	1	1	1	1	1	1	1	1	6	11
7. Repeal special rule which permits certain companies to eliminate their AMT liability.	tyba DOE	....	2	5	5	5	5	5	5	5	5	5	22	47

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
H. Pension and Employee Benefit Provisions:														
1. Provide employers the option to offer tax-free employee parking or taxable cash compensation ([14]).	tyba 12/31/97		3	8	11	12	12	13	14	14	15	16	46	118
2. Repeal of 15% excess distribution and excess accumulation taxes.	tyba & dda 12/31/96.		−18	−19	−7	18	18	16	16	14	13	11	−8	62
3. Increase in prohibited transactions excise tax.	ptoa DOE		2	4	4	4	4	4	4	4	4	4	14	34
4. Basis recovery method	aba 12/31/97		1	3	6	9	11	15	18	21	24	27	30	133
I. Other Revenue-Increase Provisions:														
1. Termination of suspense accounts for family farm corporations required to use accrual method of accounting ([15]).	([16])		29	33	35	36	37	39	40	41	43	44	170	377
2. 2-year carryback and 20-year carryforward for net operating losses with an exception related to Presidentially declared disaster areas.	NOLgi tyba DOE		42	303	361	256	179	136	112	100	93	90	1,141	1,672
3. Modification of treatment of company-owned life insurance—pro rata disallowance of interest on debt to fund life insurance.	cia 6/8/97		20	53	93	140	193	247	299	349	399	447	500	2,240
4. Modify the basis allocation rules for distributee partners, with technical modifications.	pda DOE		26	52	55	57	59	61	64	66	69	72	249	581
5. Eliminate the substantial appreciation requirement for inventory of a partnership, with technical modification and binding contract exception.	sepda DOE & efbcieo 6/8/97.		30	66	69	73	77	80	84	89	93	98	316	760

6. Earned income credit compliance provisions: deny eligibility for prior acts of recklessness; recertification required when EIC denied in past; and due diligence requirement for paid preparers.	tyba 12/31/96	....	(7)	18	25	24	21	21	21	21	21	21	88	193
7. For the purpose of the Earned Income Credit (EIC) phaseout, include in AGI nontaxable distributions of IRA, pensions, and annuities, and tax-exempt interest; and addback 75% of business losses (17).	tyba 12/31/97	....	(7)	72	75	79	85	89	92	94	99	102	312	788
8. Provide that workfare payments do not qualify as earned income for the purposes of the earned income credit.	DOE						Negligible Revenue Effect							
9. New EIC compliance proposals (18):														
a. Federal case register data ...	10/1/99	....	....	....	....	10	20	30	40	60	85	105	30	350
b. SSA parent SSNs	180da DOE	....	....	10	10	10	10	10	10	10	10	10	40	90
c. Additional appropriation for EIC enforcement.	DOE						No Revenue Effect							
10. Restrict income forecast method and allow 3-year MACRS for rent-to-own property; with clarification for home computers and cellular phones.	tyba DOE	....	29	41	62	78	38	27	25	17	17	18	248	352
11. Extend FUTA surtax and increase the statutory limit on the FUA Trust Fund from .25% of covered wages to .50% (12).	lpo/a 1/1/99	....	....	1,063	1,763	1,797	1,733	661	−73	−71	−74	−73	6,356	6,726
12. Limitation on charitable remainder trust annual payouts; require charitable remainders to have a minimum value of 10% of trust.	Ta 6/18/97	....	6	6	6	6	6	6	6	6	6	6	30	60

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
13. Limit carryback period for general business credits to 1 year; extend carryforward period to 20 years.	cai tyba 12/31/97	....	182	300	81	−60	−32	−9	5	15	21	25	471	527
14. Extend the 5-year time limit for taxing pre-contribution gain to 7 years and grandfather binding contracts in effect on 6/8/97.	pcpa dofca	....	....	....	....	....	2	10	11	11	12	12	2	58
15. Expansion of requirement that involuntarily converted property be replaced with property acquired from an unrelated person.	icoa dofca	....	1	4	6	8	11	13	15	17	19	21	30	115
16. Repeal installment sales grandfather rules of 1986 Act.	tyb1ya DOE	....	....	44	97	106	106	64	21	22	23	24	353	507
Subtotal of Revenue-Increase Provisions.	....	....	7,522	11,013	10,802	11,217	11,696	10,970	10,786	11,409	12,092	12,866	51,230	109,350
XI. Foreign Tax Provisions														
A. General Provisions:														
1. Simplify foreign tax credit limitation for individuals.	tyba 12/31/97	....	([19])	−1	−1	−1	−1	−1	−1	−1	−1	−1	−4	−9
2. Simplify translation of foreign taxes.	....	....	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])
3. Election to use simplified foreign tax credit limitation for alternative minimum tax purposes.	tyba 12/31/97	....	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	−1	−2
4. Simplify treatment of personal transactions in foreign currency.	tyba 12/31/97	....	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	−1	−2
5. Simplify foreign tax credit limitation for dividends from 10/50 companies to provide look-through starting in 2003.	tyba 12/31/02	....	....	....	....	....	....	−57	−241	−215	−227	−242	....	−982

B. General Provisions Affecting Treatment of Controlled Foreign Corporations.	**various**		**−2**	**−5**	**−7**	**−9**	**−10**	**−10**	**−11**	**−12**	**−13**	**−14**	**−33**	**−93**
C. Modification of Passive Foreign Investment Company Provisions to Eliminate Overlap With Subpart F and to Allow Mark-to-Market Election, and to Modify Asset Measurement Rule.	**tyba 12/31/97**		**−24**	**−23**	**−24**	**−26**	**−27**	**−28**	**−29**	**−31**	**−33**	**−35**	**−124**	**−280**
D. Simplify Formation and Operation of International Joint Ventures, with Technical Modifications.	**various**		(6)	(6)	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−2**	**−3**	**−9**
E. Modification of Reporting Threshold for Stock Ownership of a Foreign Corporation.	**1/1/98**		(19)	**−1**	**−2**	**−2**	**−2**	**−2**	**−2**	**−3**	**−3**	**−3**	**−7**	**−20**
F. Other Foreign Simplification Provisions:														
1. Transition rule for certain trusts	aiii SBJPA		−1	−3	−5	−5	−5	−5	−5	−5	−5	−5	−19	−44
2. Simplify application of the stock and securities trading safe harbor.	tyba 12/31/97		(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)
3. Clarification of determination of foreign taxes deemed paid.	DOE		(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)
4. Clarification of foreign tax credit limitation for financial services income.	DOE		(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)
G. Other Foreign Provisions:														
1. Foreign sales corporation benefits for computer software.	gra 12/31/97		−27	−42	−146	−173	−180	−191	−202	−227	−252	−277	−568	−1,717
2. Increase dollar limitation on section 911 exclusion and index after 2007.	1/1/98		−15	−30	−50	−67	−82	−97	−103	−111	−119	−127	−244	−801
3. Exception from U.S. property definition under subpart F for certain securities positions.	tyba 12/31/97		−1	−2	−2	−2	−2	−2	−2	−2	−2	−2	−9	−19
4. Exemption from subpart F for active financing income.	tybi 1998		−23	−68	−3								−94	−94

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
5. Treat service income of non-resident alien individuals earned on foreign ships as foreign source income and disregard the U.S. presence of such individuals; with amendment to rule disregarding U.S. presence.	tyba 12/31/97	....	−2	−4	−3	−3	−3	−3	−3	−3	−3	−3	−15	−30
Subtotal of Foreign Tax Provisions.	....	....	**−95**	**−179**	**−244**	**−289**	**−313**	**−397**	**−600**	**−611**	**−659**	**−711**	**−1,122**	**−4,102**
XII Simplification Provisions Relating to Individuals and Businesses														
A. Provisions Relating to Individuals:														
1. Deduction attributable to unearned income of dependent filers: greater of (a) present law; or (b) earned income plus $250; delink dependent AMT from parent's AMT position.	1/1/98	....	−2	−38	−35	−35	−35	−35	−35	−38	−37	−36	−146	−327
2. Increase de minimis threshold for estimated tax to $1,000.	tyba 12/31/97	....	−134	−17	−18	−19	−20	−21	−22	−24	−25	−26	−208	−326
3. Treatment of certain reimbursed expenses of rural mail carriers.	tyba 12/31/97	....	(6)	−1	−1	−1	−1	−1	−1	−1	−1	−1	−5	−11
4. Treatment of travel expenses of certain Federal employees engaged in criminal investigations.	eii tyea DOE	....	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	−1	−2
5. Permit payment of taxes by any commercially acceptable means; and prohibit payment of fees by Treasury.	DOE	Negligible Revenue Effect												

B. Provisions Relating to Businesses Generally:														
1. Modify look-back method for long-term contracts.	cci tyea DOE	....	−1	−2	−3	−4	−4	−4	−4	−5	−5	−5	−14	−37
2. Minimum tax treatment of certain property and casualty insurance companies.	tyba 12/31/97	....	−1	−2	−3	−3	−3	−3	−3	−3	−3	−3	−12	−27
3. Provide for exclusion for construction allowances provided to lessees, with technical modification.	leia DOE	....	Negligible Revenue Effect											
C. Partnership Simplification Provisions:														
1. Simplified reporting to partners	tyba 12/31/97	....	6	8	8	8	8	9	9	9	9	9	38	83
2. Simplified audit procedure for large partnerships.	tyba 12/31/97	....	(7)	(7)	(7)	1	1	1	1	1	1	1	2	8
3. Due date for furnishing information to partners of large partnerships.	tyba 12/31/97	....	No Revenue Effect											
4. Returns required on magnetic media for partnerships with 100 partners or more.	tyba 12/31/97	....	Negligible Revenue Effect											
5. Other partnership audit rules	tyba 12/31/97	....	−2	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	−3	−5
6. Closing partnership taxable year with respect to deceased partner.	tyba 12/31/97	....	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	−1	−1
D. Provisions Relating to Real Estate Investment Trusts:														
1. Alternative penalty for failure to request information from shareholders.	tyba DOE	....	Negligible Revenue Effect											
2. De minimis rule for tenant services income.	tyba DOE	....	Negligible Revenue Effect											
3. Attribution rules applicable to tenant services.	tyba DOE	....	Negligible Revenue Effect											
4. Credit for tax paid by REIT on retained capital gains.	tyba DOE	....	Negligible Revenue Effect											
5. Repeal 30% gross income requirement.	tyba DOE	....	−4	−5	−5	−6	−7	−7	−8	−9	−10	−11	−26	−72
6. Modification of earnings and profits rules for determining whether REIT has earnings and profits from non-REIT year.	tyba DOE	....	Negligible Revenue Effect											

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
7. Treatment of foreclosure property	tyba DOE							Negligible Revenue Effect						
8. Payments under hedging instruments.	tyba DOE							Negligible Revenue Effect						
9. Excess noncash income	tyba DOE							Negligible Revenue Effect						
10. Prohibited transaction safe harbor.	tyba DOE							Negligible Revenue Effect						
11. Shared appreciation mortgages	tyba DOE							Negligible Revenue Effect						
12. Wholly owned subsidiaries	tyba DOE							Negligible Revenue Effect						
E. Provision Relating to Regulated Investment Companies:														
1. Repeal 30% gross income limitation for regulated investment companies.	tyba DOE		−17	−23	−27	−33	−38	−45	−53	−61	−71	−82	−138	−450
F. Taxpayer Protections:														
1. Provide "reasonable cause" exception for filing claims for refunds.	tyba DOE							Negligible Revenue Effect						
2. Clarification of period for filing claims for refunds.	tyea DOE							Negligible Revenue Effect						
3. Repeal authority to disclose whether a prospective juror has been audited.	pca DOE							No Revenue Effect						
4. Clarify statute of limitations for pass-through entities.	tyba DOE							No Revenue Effect						
5. Clarify procedure for administrative cost awards.	aca DOE							No Revenue Effect						
Subtotal of Simplification Provisions Relating to Individuals and Businesses.			**−155**	**−80**	**−84**	**−92**	**−99**	**−106**	**−116**	**−131**	**−142**	**−154**	**−514**	**−1,167**

XIII. Estate, Gift and Trust Simplification Provisions														
1. Gifts to charities of over $10,000 exempt from gift tax filing requirements.	gma DOE							Negligible Revenue Effect						
2. Clarification of waiver of certain rights of recovery of estate tax from QTIP trust.	dda DOE							Negligible Revenue Effect						
3. Transitional rules under section 2056A.	aiii OBRA'90							Negligible Revenue Effect						
4. Estate and gift tax treatment of short-term OID instruments.	dda DOE							Negligible Revenue Effect						
5. Certain revocable trusts treated as part of estate.	dda DOE		−3	−3	−3	−3	−3	−3	−3	−3	−3	−3	−15	−30
6. Distributions during first 65 days of taxable year of estate.	tyba DOE							Negligible Revenue Effect						
7. Separate share rules available to estates.	dda DOE							Negligible Revenue Effect						
8. Executor of estate and beneficiaries treated as related persons for disallowance of losses.	tyba DOE							Negligible Revenue Effect						
9. Treatment of funeral trusts	tyea DOE		2	2	2	2	2	2	2	2	2	2	10	20
10. Adjustments for certain gifts within 3 years of decedent's death.	dda DOE							No Revenue Effect						
11. Clarification of treatment of survivor annuities under qualified terminable interest rules.	dda DOE							Negligible Revenue Effect						
12. Treatment under qualified domestic trust rules of forms of ownership which are not trusts.	dda DOE							Negligible Revenue Effect						
13. Opportunity to correct certain failures under section 2032A.	DOE							Negligible Revenue Effect						
14. Authority to waive requirement of United States trustee for qualified domestic trusts.	dda DOE							No Revenue Effect						
Subtotal of Estate, Gift and Trust Simplification Provisions.			**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−1**	**−5**	**−10**

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
XIV. Excise Tax and Other Simplification Provisions														
A. Excise Tax Simplification:														
1. Increase de minimis limit for aftermarket alterations for heavy truck and luxury car excises.	DOE	....							Negligible Revenue Effect					
2. Credit or refund for imported bottled distilled spirits returned to distilled spirits plant.	fcq DOE+180 days	....							Negligible Revenue Effect					
3. Authority to cancel or credit export bonds without submission of records.	fcq DOE+180 days	....							No Revenue Effect					
4. Repeal of required maintenance of records on premises of distilled spirits plant.	fcq DOE+180 days	....							No Revenue Effect					
5. Fermented material from any brewery may be received at a distilled spirits plant.	fcq DOE+180 days	....							Negligible Revenue Effect					
6. Repeal of requirement for wholesale dealers in liquors to post sign.	DOE	....							No Revenue Effect					
7. Refund of tax to wine returned to bond not limited to unmerchantable wine.	fcq DOE+180 days	....							Negligible Revenue Effect					
8. Use of additional ameliorating material in certain wines.	fcq DOE+180 days	....							No Revenue Effect					
9. Domestically produced beer may be withdrawn free of tax for use of foreign embassies, legations, etc.	fcq DOE+180 days	....							Negligible Revenue Effect					
10. Beer may be withdrawn free of tax for destruction.	fcq DOE+180 days	....							Negligible Revenue Effect					

11. Authority to allow drawback on exported beer without submission of records.	fcq DOE+180 days	....	No Revenue Effect											
12. Imported beer or wine transferred in bulk to brewery or winery without payment of tax.	fcq DOE+180 days	....	Negligible Revenue Effect											
13. Authority for IRS to grant exemption from excise tax registration requirements.	DOE	....	No Revenue Effect											
14. Exemption from truck excise tax for certain wrecked truck fixups and truck modifications.	1/1/98	....	−5	−8	−8	−8	−9	−9	−10	−10	−11	−11	−38	−89
15. Repeal registration requirement for tax-free sales of trucks for resale.	1/1/98	....	Negligible Revenue Effect											
16. Repeal of excise tax ''deadwood'' provision.	DOE	....	No Revenue Effect											
17. Move taxation of arrows from tax on assembled arrows to tax on component parts of 12.4%.	1/1/98	....	Negligible Revenue Effect											
18. Clarify tax treatment of skydiving flights as noncommercial aviation; with technical modifications.	10/1/97	....	Negligible Revenue Effect											
19. Eliminate double taxation for certain purchases of aviation fuel from fixed-based operators; with technical modifications.	10/1/97	....	Negligible Revenue Effect											
B. Tax Exempt Bond Provisions:														
1. Repeal $100,000 limitation on unspent proceeds from tax-exempt bond issues under year exception from rebate.	bia DOE	....	([6])	−2	−3	−5	−6	−8	−9	−10	−11	−12	−17	−65
2. Exclusion from arbitrage rebate for earnings on bona fide debt service fund under construction bond rules.	bia DOE	....	([6])	−1	−2	−3	−3	−4	−5	−6	−6	−7	−9	−37
3. Repeal of debt service based limitation on investment in certain nonpurpose investments.	bia DOE	....	Negligible Revenue Effect											

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
4. Repeal of expired student loan bond arbitrage rebate provisions.	DOE	....	No Revenue Effect											
C. Tax Court Procedures:														
1. Clarify jurisdiction of Tax Court with respect to overpayment determinations.	DOE	....	−3	−3	−3	−3	−3	−3	−3	−3	−3	−3	−15	−30
2. Clarify Tax Court jurisdiction over interest determinations.	DOE	....	No Revenue Effect											
3. Clarify net worth requirements for awards of administrative or litigation costs; $4 million for joint returns.	DOE	....	−1	−2	−2	−2	−2	−2	−2	−2	−2	−2	−9	−19
4. Clarify Tax Court jurisdiction for independent contractors with technical modification.	DOE	....	Negligible Revenue Effect											
D. Other Provisions:														
1. Extend due date for first quarter estimated tax by private foundations.	tyba DOE	....	−2	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	−2	−3
2. Clarification of authority to withhold Puerto Rico income taxes from salaries of Federal employees..	1/1/98	....	−2	−3	−1	−1	−1	−1	−1	−1	−1	−1	−8	−13
3. Certain notices disregarded under provision increasing interest rate on large corporate underpayments.	1/1/98	....	−1	−1	−1	−1	−1	−1	−1	−1	−1	−1	−5	−10
Subtotal of Excise Tax and Other Simplification Provisions.	....	....	**−14**	**−20**	**−20**	**−23**	**−25**	**−28**	**−31**	**−33**	**−35**	**−37**	**−103**	**−266**

XV. Pension Simplification Provisions														
A. Miscellaneous Provisions Relating to Pensions and Other Provisions:														
1. Water districts made eligible for 401(k) plans even if State or local entity.	1/1/98	....	([19])	−1	−1	−1	−2	−2	−2	−2	−2	−3	−6	−15
2. Extend moratorium on non-discrimination rules for public pension plans (permanent), with technical modification.	DOE	....						Negligible Revenue Effect						
3. Treatment of certain disability benefits received by former police officers or firefighters.	DOE	....	....	−10	−1	....	....	....	....	....	....	....	−11	−11
4. ESOP provision—Modify prohibited transaction rules relating to employee stock ownership plans of S corporation; with modifications.	tyba 12/31/97	....						Negligible Revenue Effect						
5. Repeal UBIT on income from an S corporation to an ESOP; with technical modification.	tyba 12/31/97	....	−8	−23	−34	−41	−44	−46	−48	−50	−52	−54	−149	−400
6. Pension provision—increase in full funding limit with 20-year amortization; with technical modification.	pyba 12/31/98	....	....	−4	−12	−14	−18	−19	−23	−23	−25	−25	−48	−164
7. Deduction for contributions made by ministers to retirement plans.	tyba 12/31/97	....						Negligible Revenue Effect						
8. Exclusion of ministers from discrimination testing of non-denominational retirement plans.	tyba 12/31/97	....						Negligible Revenue Effect						
9. Diversification of 401(k) investments; with 1-year delay of effective date.	DOE	....						Negligible Revenue Effect						
10. Exempt police and firefighters from section 415 dollar limitation; with clarification.	yba 12/31/96	....						Negligible Revenue Effect						
11. Modify section 415 limits for State and local plans; with modifications.	tyba 12/31/97	....	−9	−25	−25	−26	−26	−26	−27	−27	−27	−28	−111	−246

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT ON THE REVENUE PROVISIONS OF H.R. 2014, THE "TAXPAYER RELIEF ACT OF 1997"—Continued

[Fiscal Years 1997–2007, in millions of dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997–2002	1997–2007
12. ESOP provision—permit cash distributions in lieu of stock in the S corporation.	tyba 12/31/97	....						Negligible Revenue Effect						
13. Increase the amount from $3,500 to $5,000 on involuntary cash out from pension plans with no indexing of dollar amount.	dma DOE	([7])	2	6	7	7	7	8	8	9	9	10	29	73
14. Treatment for partnership items of individual retirement accounts.	tyba 12/31/97	....						No Revenue Effect						
15. Church plan exception to prohibition on discrimination against individuals based on health status.	DOE	....						Negligible Revenue Effect						
16. Excise tax penalties for failure of group health plan to provide certain maternity and mental health benefits.	pybo/a 1/1/98	....						Negligible Revenue Effect						
17. Date for adoption of plan amendments.	DOE	....						No Revenue Effect						
B. Pension Simplification Provisions:														
1. Matching contributions for self-employed individuals not treated as elective deferrals.	tyba 12/31/97	....	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([20])	([21])
2. Contributions to IRAs through payroll deductions.	tyba 12/31/97	....						No Revenue Effect						
3. Plans not disqualified merely by accepting rollover contributions; with modification.	tyba 12/31/97	....						Negligible Revenue Effect						
4. Modification of prohibition on assignment or alienation.	DOE	....						Negligible Revenue Effect						
5. Eliminate paperwork burdens on plans.	tyba DOE	....						No Revenue Effect						
6. Modifications to section 403(b) exclusion allowance to conform to section 415 modifications.	tyba 12/31/98	....	....	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([19])	([20])	([21])

7. New technologies in retirement plans.	DOE	....	No Revenue Effect											
8. Modification of 10% tax on non-deductible contributions.	tyba 12/31/97	....	−2	−3	−3	−3	−3	−3	−3	−3	−3	−3	−14	−29
9. Modify funding rules for certain plans.	cda 12/31/97	....	Negligible Revenue Effect											
Subtotal of Pension Simplification Provisions.	....	....	−27	−51	−68	−78	−86	−88	−95	−96	−100	−103	−310	−792
XVI. Technical Corrections Provisions														
1. Oklahoma technical on Indian wage credits and development incentives for property with 10-year lives or less, with modification.	dwcorfpt 3/18/97	....	−10	−2	1	2	2	1	1	1	1	1	−8	−2
Subtotal of Technical Corrections Provisions.	....	−10	−2	1	2	2	1	1	1	1	1	−8	−2	
XVII. TRADE PROVISION—GSP extension through 6/30/98 [12]	**6/1/97**	....	**−378**	....	....	....	....	....	....	....	....	....	**−378**	**−378**
Total Revenue Effect of H.R. 2014	....	**60**	**−9,483**	**−9,887**	**−27,937**	**−29,329**	**−23,865**	**−34,966**	**−36,611**	**−38,652**	**−39,809**	**−41,551**	**−100,444**	**−292,045**
XVIII. REVENUE PROVISIONS IN H.R. 2015														
1. Increase small cigarettes tax by $0.10 per pack in 2000 and 2001, and $0.15 per pack in 2002 and thereafter with proportionate increase in other tobacco products excise taxes.	10/1/97	....	....	....	1,175	1,720	2,272	2,280	2,290	2,300	2,310	2,320	5,167	16,667
2. Miscellaneous FUTA provisions [12]	various	....	3	([6])	([6])	([6])	([6])	([6])	([6])	([6])	([6])	([6])	1	....
3. Medicare Plus MSAs	tyba 12/31/97	....	Negligible Revenue Effect											
Total Revenue Effect of H.R. 2015	....	....	**3**	**[6]**	**1,175**	**1,720**	**2,272**	**2,280**	**2,290**	**2,300**	**2,310**	**2,320**	**5,168**	**16,667**
Grand Total: Reconciliation Revenue Provisions.	....	**60**	**−9,480**	**−9,887**	**−26,762**	**−27,609**	**−21,593**	**−32,686**	**−34,321**	**−36,352**	**−37,499**	**−39,231**	**−95,276**	**−275,378**

[1] Estimate considers interaction with HOPE tax credit proposal.
[2] The refundable portion of the child credit is equal to $4,281 million for fiscal years 1998–2002 and $10,022 million for fiscal years 1998–2007.
[3] Estimate includes interaction with estate and gift taxes.

[4] Considers interaction with IRA PLUS proposal.

[5] Estimate includes interaction with welfare-to-work tax credit.

[6] Loss of less than $500,000.

[7] Gain of less than $500,000.

[8] Effective for bonds issued after 12/31/96 and bonds issued before 1/1/99.

[9] Effective for expenses in taxable years ending after date of enactment and before 1/1/01.

[10] Effective for payments received in taxable years beginning after 12/31/96 with respect to individuals dying after such date.

[11] Assumes prior or concurrent passage of legislation to allow Virgin Island financing on parity basis.

[12] Estimate provided by the Congressional Budget Office.

[13] Rural airports would be defined as (1) airports receiving ''essential air service'' assistance on date of enactment and having fewer than 100,000 enplanements in the previous calendar year, and (2) other airports having fewer than 100,000 passenger enplanements in the previous calendar year, excluding those within 75 miles of airports having more than 100,000 passenger enplanements in the previous year.

[14] Estimate does not include increase in receipts to Social Security trust fund ($21 million for fiscal years 1997–2002; $51 million for fiscal years 1997–2007).

[15] The provision would eliminate the present-law requirement that a portion of the suspense account be restored to income whenever the gross receipts of the corporation decline.

[16] Provision would be effective for taxable years ending after 6/8/97 for new suspense accounts, and taxable years beginning after that date for existing accounts. Balances in new accounts would be included in income over a 10-year period, and balances in existing accounts over a 20-year period. For existing accounts, the amounts included in income in any year would not exceed 50% of the taxable income of the taxpayer before the inclusion.

[17] Estimate includes outlay reductions of $254 million for 1997–2002 and $650 million for 1997–2007.

[18] Estimate does not include effect on outlays. Outlays will be provided by the Congressional Budget Office.

[19] Loss of less than $1 million.

[20] Loss of less than $5 million.

[21] Loss of less than $10 million.

Legend for ''Effective'' column: ab=and before; aba=annuities beginning after; aca=actions commenced after; aiii OBRA'90=as if included in the Omnibus Budget Reconciliation Act of 1990; aiii SBJPA=as if included in the Small Business Job Protection Act of 1996; aoty=all open taxable years; bia=bonds issued after; cai=credits arising in; cci=contracts completed in; cda=contributions due after; cfa=claims filed after; cia=contracts issued after; csa=constructive sales after; da=distributions after; Da=discharges after; da/a=distributions and acquisitions after; dda=decedents dying after; di=dispositions in; dma=disclosures made after; DOE=date of enactment; dofca=date of first committee action; dpoaa=dividends paid or accrued after; droaa=dividends received or accrued after; dwcorfpt=depreciation and wages claimed on returns filed prior to; efbcieo=exception for binding contracts in effect on; eia=expenses incurred after; eii=expenses incurred in; fcq DOE + 180 days=first day of the calendar quarter that begins at least 180 days after date of enactment; ftpoa=foreign taxes paid or accrued in; gma=gifts made after; gra=gross receipts after; gsta=generation skipping transfers after; icoa=involuntary conversions occurring after; lia=instruments issued after; leia=leases entered into after; lia=levies issued after; lpo/a=labor performed on or after; NOLgi=net operating losses generated in; oia=obligations issued after; pca=proceedings commenced after; pcpa=property contributed to partnership after; pda=partnership distributions after; pma=payments made after; po/a=purchases on or after; poida=payments of interest due after; ppisa=property placed in service after; psora=payments solicited or received after; ptoa=prohibited transactions occurring after; pyba=plans years beginning after; phybo/a=plans years beginning on or after; rd=returns due; rfa=returns filed after; roa=rentals occurring after (for returns open on date of first committee action); Sa=sales after; sea=sales or exchanges after; sepda=sales and exchanges, and certain partnership distributions after; spa=services performed after; ta=transactions after; Ta=transfers after; tyba=taxable years beginning after; tybo/a=taxable years beginning on or after; tyb1ya=taxable years beginning 1 year after; tybi=taxable years beginning in; tyea=tax years ending after; tsoaiTg=tax shelters offered after issuance of Treasury guidance; wpoifhma=wages paid or incurred for hires made after; yba=years beginning after; 30da=30 days after; 90da=90 days after; 180da=180 days after; 2ya=2 years after.

Note.—Details may not add to totals due to rounding. Enactment date is assumed to be August 15, 1997.

Source: Joint Committee on Taxation.

For consideration of the House bill, and the Senate amendment, and modifications committed to conference:

JOHN R. KASICH,
BILL ARCHER,
PHIL CRANE,
WILLIAM M. THOMAS,
DICK ARMEY,
TOM DELAY,
CHARLES B. RANGEL,

As additional conferees from the Committee on Transportation and Infrastructure, for consideration of secs. 702 and 704 of the Senate amendment, and modifications committed to conference:

BUD SHUSTER,
SUSAN MOLINARI,
JAMES L. OBERSTAR,

As additional conferees from the Committee on Education and the Workforce, for consideration of secs. 713–14, 717, 879, 1302, 1304–5, and 1311 of the Senate amendment, and modifications committed to conference:

BILL GOODLING,
HARRIS W. FAWELL,
DONALD M. PAYNE,
Managers on the Part of the House.

From the Committee on Finance:

BILL ROTH,
TRENT LOTT,
DANIEL P. MOYNIHAN,

From the Committee on the Budget:

PETE DOMENICI,
DON NICKLES,
FRANK R. LAUTENBERG,
Managers on the Part of the Senate.