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HOUSE OF REPRESENTATIVES

REPORT
105–739

TAXPAYER RELIEF ACT OF 1998

SEPTEMBER 23, 1998.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

REPORT

together with

DISSENTING VIEWS

[To accompany H.R. 4579]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 4579) to provide tax relief for individuals, families, and farming and other small businesses, to provide tax incentives for education, to extend certain expiring provisions, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:

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

SECTION 1. SHORT TITLE, ETC.

(a) SHORT TITLE.—This Act may be cited as the "Taxpayer Relief Act of 1998".

(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.

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TITLE I—PROVISIONS PRIMARILY AFFECTING INDIVIDUALS AND FAMILIES

Subtitle A—General Provisions

SEC. 101. ELIMINATION OF MARRIAGE PENALTY IN STANDARD DEDUCTION.

(a) IN GENERAL.—Paragraph (2) of section 63(c) (relating to standard deduction) is amended—

(1) by striking "$5,000" in subparagraph (A) and inserting "twice the dollar amount in effect under subparagraph (C) for the taxable year",

(2) by adding "or" at the end of subparagraph (B),

(3) by striking "in the case of" and all that follows in subparagraph (C) and inserting "in any other case.", and

(4) by striking subparagraph (D).

(b) ADDITIONAL STANDARD DEDUCTION FOR AGED AND BLIND TO BE THE SAME FOR MARRIED AND UNMARRIED INDIVIDUALS.—

(1) Paragraphs (1) and (2) of section 63(f) are each amended by striking "$600" and inserting "$750".

(2) Subsection (f) of section 63 is amended by striking paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 1(f)(6) is amended by striking "(other than with" and all that follows through "shall be applied" and inserting "(other than with respect to sections 63(c)(4) and 151(d)(4)(A)) shall be applied".

(2) Paragraph (4) of section 63(c) is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to the amount referred to in paragraph (2)(A)."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

SEC. 102. EXEMPTION OF CERTAIN INTEREST AND DIVIDEND INCOME FROM TAX.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 (relating to amounts specifically excluded from gross income) is amended by inserting after section 115 the following new section:

"SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS AND INTEREST RECEIVED BY INDIVIDUALS.

"(a) EXCLUSION FROM GROSS INCOME.—Gross income does not include dividends and interest received during the taxable year by an individual.

"(b) LIMITATIONS.—

"(1) MAXIMUM AMOUNT.—The aggregate amount excluded under subsection (a) for any taxable year shall not exceed $200 ($400 in the case of a joint return).

"(2) CERTAIN DIVIDENDS EXCLUDED.—Subsection (a) shall not apply to any dividend from a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is a corporation exempt from tax under section 501 (relating to certain charitable, etc., organization) or section 521 (relating to farmers' cooperative associations).

"(c) SPECIAL RULES.—For purposes of this section—

"(1) EXCLUSION NOT TO APPLY TO CAPITAL GAIN DIVIDENDS FROM REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

"For treatment of capital gain dividends, see sections 854(a) and 857(c).

"(2) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only—

"(A) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends and interest which are effectively connected with the conduct of a trade or business within the United States, or

"(B) in determining the tax imposed for the taxable year pursuant to section 877(b).

"(3) DIVIDENDS FROM EMPLOYEE STOCK OWNERSHIP PLANS.—Subsection (a) shall not apply to any dividend described in section 404(k)."

(b) CONFORMING AMENDMENTS.—

(1)(A) Subparagraph (A) of section 135(c)(4) is amended by inserting "116," before "137".

(B) Subsection (d) of section 135 is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

"(4) COORDINATION WITH SECTION 116.—This section shall be applied before section 116."

(2) Paragraph (2) of section 265(a) is amended by inserting before the period ", or to purchase or carry obligations or shares, or to make deposits, to the extent the interest thereon is excludable from gross income under section 116".

(3) Subsection (c) of section 584 is amended by adding at the end thereof the following new flush sentence:

"The proportionate share of each participant in the amount of dividends or interest received by the common trust fund and to which section 116 applies shall be considered for purposes of such section as having been received by such participant."

(4) Subsection (a) of section 643 is amended by redesignating paragraph (7) as paragraph (8) and by inserting after paragraph (6) the following new paragraph:

"(7) DIVIDENDS OR INTEREST.—There shall be included the amount of any dividends or interest excluded from gross income pursuant to section 116."

(5) Section 854(a) is amended by inserting "section 116 (relating to partial exclusion of dividends and interest received by individuals) and" after "For purposes of".

(6) Section 857(c) is amended to read as follows:

"(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

"(1) TREATMENT FOR SECTION 116.—For purposes of section 116 (relating to partial exclusion of dividends and interest received by individuals), a capital gain dividend (as defined in subsection (b)(3)(C)) received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

"(2) TREATMENT FOR SECTION 243.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend."

(7) The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 115 the following new item:

"Sec. 116. Partial exclusion of dividends and interest received by individuals."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1998.

SEC. 103. NONREFUNDABLE PERSONAL CREDITS ALLOWED AGAINST ALTERNATIVE MINIMUM TAX.

(a) IN GENERAL.—Subsection (a) of section 26 is amended to read as follows:

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the sum of—

"(1) the taxpayer's regular tax liability for the taxable year, and

"(2) the tax imposed for the taxable year by section 55(a).

For purposes of applying the preceding sentence, paragraph (2) shall be treated as being zero for any taxable year beginning during 1998.".

(b) CONFORMING AMENDMENTS.—

(1) Subsection (d) of section 24 is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(2) Section 32 is amended by striking subsection (h).

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

SEC. 104. 100 PERCENT DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—Paragraph (1) of section 162(l) (relating to special rules for health insurance costs of self-employed individuals) is amended to read as follows:

"(1) ALLOWANCE OF DEDUCTION.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to 100 percent of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1998.

SEC. 105. SPECIAL RULE FOR MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE IN DETERMINING EXCLUSION OF GAIN FROM SALE OF PRINCIPAL RESIDENCE.

(a) IN GENERAL.—Subsection (d) of section 121 (relating to exclusion of gain from sale of principal residence) is amended by adding at the end the following new paragraph:

"(9) MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE.—

"(A) IN GENERAL.—The running of the 5-year period described in subsection (a) shall be suspended with respect to an individual during any time that such individual or such individual's spouse is serving on qualified official extended duty as a member of the uniformed services or of the Foreign Service.

"(B) QUALIFIED OFFICIAL EXTENDED DUTY.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified official extended duty' means any period of extended duty as a member of the uniformed services or a member of the Foreign Service during which the member serves at a duty station which is at least 50 miles from such property or is under Government orders to reside in Government quarters.

"(ii) UNIFORMED SERVICES.—The term 'uniformed services' has the meaning given such term by section 101(a)(5) of title 10, United States Code, as in effect on the date of the enactment of the Taxpayer Relief Act of 1998.

"(iii) FOREIGN SERVICE OF THE UNITED STATES.—The term 'member of the Foreign Service' has the meaning given the term 'member of the Service' by paragraph (1), (2), (3), (4), or (5) of section 103 of the Foreign Service Act of 1980, as in effect on the date of the enactment of the Taxpayer Relief Act of 1998.

"(iv) EXTENDED DUTY.—The term 'extended 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.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to sales and exchanges after the date of the enactment of this Act.

SEC. 106. $1,000,000 EXEMPTION FROM ESTATE AND GIFT TAXES.

(a) IN GENERAL.—Subsection (c) of section 2010 (relating to applicable credit amount) is amended to read as follows:

"(c) APPLICABLE CREDIT AMOUNT.—

"(1) IN GENERAL.—For purposes of this section, the applicable credit amount is $345,800.

"(2) APPLICABLE EXCLUSION AMOUNT.—For purposes of the provisions of this title which refer to this subsection, the applicable exclusion amount is $1,000,000."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying, and gifts made, after December 31, 1998.

Subtitle B—Provisions Relating to Education

SEC. 111. ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.

(a) IN GENERAL.—Paragraph (1) of section 529(b) (defining qualified State tuition program) is amended by inserting "or by 1 or more eligible educational institutions" after "maintained by a State or agency or instrumentality thereof".

(b) TECHNICAL AMENDMENTS.—

(1) The texts of sections 72(e)(9), 135(c)(2)(C), 135(d)(1)(D), 529, 530, and 4973(e)(1)(B) are each amended by striking "qualified State tuition program" each place it appears and inserting "qualified tuition program".

(2) The paragraph heading for paragraph (9) of section 72(e) and the subparagraph heading for subparagraph (B) of section 530(b)(2) are each amended by striking "STATE".

(3) The subparagraph heading for subparagraph (C) of section 135(c)(2) is amended by striking "QUALIFIED STATE TUITION PROGRAM" and inserting "QUALIFIED TUITION PROGRAMS".

(4) Sections 529(c)(3)(D)(i) and 6693(a)(2)(C) are each amended by striking "qualified State tuition programs" and inserting "qualified tuition programs".

(5)(A) The section heading of section 529 is amended to read as follows:

"SEC. 529. QUALIFIED TUITION PROGRAMS.".

(B) The item relating to section 529 in the table of sections for part VIII of subchapter F of chapter 1 is amended by striking "State".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1999.

SEC. 112. MODIFICATION OF ARBITRAGE REBATE RULES APPLICABLE TO PUBLIC SCHOOL CONSTRUCTION BONDS.

(a) IN GENERAL.—Subparagraph (C) of section 148(f)(4) is amended by adding at the end the following new clause:

"(xviii) 4-YEAR SPENDING REQUIREMENT FOR PUBLIC SCHOOL CONSTRUCTION ISSUE.—

"(I) IN GENERAL.—In the case of a public school construction issue, the spending requirements of clause (ii) shall be treated as met if at least 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued, 30 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date, 50 percent of such proceeds are spent for such purposes within the 3-year period beginning on such date, and 100 percent of such proceeds are spent for such purposes within the 4-year period beginning on such date.

"(II) PUBLIC SCHOOL CONSTRUCTION ISSUE.—For purposes of this clause, the term 'public school construction issue' means any construction issue if no bond which is part of such issue is a private activity bond and all of the available construction proceeds of such issue are to be used for the construction (as defined in clause (iv)) of public school facilities to provide education or training below the postsecondary level or for the acquisition of land that is functionally related and subordinate to such facilities.

"(III) OTHER RULES TO APPLY.—Rules similar to the rules of the preceding provisions of this subparagraph which apply to clause (ii) also apply to this clause."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to obligations issued after December 31, 1998.

Subtitle C—Provisions Relating to Social Security

SEC. 121. INCREASES IN THE SOCIAL SECURITY EARNINGS LIMIT FOR INDIVIDUALS WHO HAVE ATTAINED RETIREMENT AGE.

(a) IN GENERAL.—Section 203(f)(8)(D) of the Social Security Act (42 U.S.C. 403(f)(8)(D)) is amended by striking clauses (iv) through (vii) and inserting the following new clauses:

"(iv) for each month of any taxable year ending after 1998 and before 2000, $1,416.66⅔, "(v) for each month of any taxable year ending after 1999 and before 2001, $1,541.66⅔,

"(vi) for each month of any taxable year ending after 2000 and before 2002, $2,166.66⅔,

"(vii) for each month of any taxable year ending after 2001 and before 2003, $2,500.00,

"(viii) for each month of any taxable year ending after 2002 and before 2004, $2,608.33⅓,

"(ix) for each month of any taxable year ending after 2003 and before 2005, $2,833.33⅓,

"(x) for each month of any taxable year ending after 2004 and before 2006, $2,950.00,

"(xi) for each month of any taxable year ending after 2005 and before 2007, $3,066.66⅔,

"(xii) for each month of any taxable year ending after 2006 and before 2008, $3,195.83⅓, and

"(xiii) for each month of any taxable year ending after 2007 and before 2009, $3,312.50.".

(b) CONFORMING AMENDMENTS.—

(1) Section 203(f)(8)(B)(ii) of such Act (42 U.S.C. 403(f)(8)(B)(ii)) is amended—

(A) by striking "after 2001 and before 2003" and inserting "after 2007 and before 2009"; and

(B) in subclause (II), by striking "2000" and inserting "2006".

(2) The second sentence of section 223(d)(4)(A) of such Act (42 U.S.C. 423(d)(4)(A)) is amended by inserting "and section 121 of the Taxpayer Relief Act of 1998" after "1996".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to taxable years ending after 1998.

SEC. 122. RECOMPUTATION OF BENEFITS AFTER NORMAL RETIREMENT AGE.

(a) IN GENERAL.—Section 215(f)(2)(D)(i) of the Social Security Act (42 U.S.C. 415(f)(2)(D)(i)) is amended to read as follows:

"(i) in the case of an individual who did not die in the year with respect to which the recomputation is made, for monthly benefits beginning with benefits for January of—

"(I) the second year following the year with respect to which the recomputation is made, in any such case in which the individual is entitled to old-age insurance benefits, the individual has attained retirement age (as defined in section 216(l)) as of the end of the year preceding the year with respect to which the recomputation is made, and the year with respect to which the recomputation is made would not be substituted in recomputation under this subsection for a benefit computation year in which no wages or self-employment income have been credited previously to such individual, or

"(II) the first year following the year with respect to which the recomputation is made, in any other such case; or".

(b) CONFORMING AMENDMENTS.—

(1) Section 215(f)(7) of such Act (42 U.S.C. 415(f)(7)) is amended by inserting ", and as amended by section 122(b)(2) of the Taxpayer Relief Act of 1998," after "This subsection as in effect in December 1978".

(2) Subparagraph (A) of section 215(f)(2) of the Social Security Act as in effect in December 1978 and applied in certain cases under the provisions of such Act as in effect after December 1978 is amended—

(A) by striking "in the case of an individual who did not die" and all that follows and inserting "in the case of an individual who did not die in the year with respect to which the recomputation is made, for monthly benefits beginning with benefits for January of—"; and

(B) by adding at the end the following:

"(i) the second year following the year with respect to which the recomputation is made, in any such case in which the individual is entitled to old-age insurance benefits, the individual has attained age 65 as of the end of the year preceding the year with respect to which the recomputation is made, and the year with respect to which the recomputation is made would not be substituted in recomputation under this subsection for a benefit computation year in which no wages or self-employment income have been credited previously to such individual, or

"(ii) the first year following the year with respect to which the recomputation is made, in any other such case; or".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to recomputations of primary insurance amounts based on wages paid and self employment income derived after 1997 and with respect to benefits payable after December 31, 1998.

TITLE II—PROVISIONS PRIMARILY AFFECTING FARMING AND OTHER BUSINESSES

Subtitle A—Increase in Expense Treatment for Small Businesses

SEC. 201. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.

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

"(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $25,000."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1998.

Subtitle B—Provisions Relating to Farmers

SEC. 211. INCOME AVERAGING FOR FARMERS MADE PERMANENT.

Subsection (c) of section 933 of the Taxpayer Relief Act of 1997 is amended by striking ", and before January 1, 2001".

SEC. 212. 5-YEAR NET OPERATING LOSS CARRYBACK FOR FARMING LOSSES.

(a) IN GENERAL.—Paragraph (1) of section 172(b) (relating to net operating loss deduction) is amended by adding at the end the following new subparagraph:

"(G) FARMING LOSSES.—In the case of a taxpayer which has a farming loss (as defined in subsection (i)) for a taxable year, such farming loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss."

(b) FARMING LOSS.—Section 172 is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) RULES RELATING TO FARMING LOSSES.—For purposes of this section—

"(1) IN GENERAL.—The term 'farming loss' means the lesser of—

"(A) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) are taken into account, or

"(B) the amount of the net operating loss for such taxable year.

"(2) COORDINATION WITH SUBSECTION (B)(2).—For purposes of applying subsection (b)(2), a farming loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

"(3) ELECTION.—Any taxpayer entitled to a 5-year carryback under subsection (b)(1)(G) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(G). Such election shall be made in such manner as may be prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year."

(c) COORDINATION WITH FARM DISASTER LOSSES.—Clause (ii) of section 172(b)(1)(F) is amended by adding at the end the following flush sentence:

"Such term shall not include any farming loss (as defined in subsection (i))."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to net operating losses for taxable years beginning after December 31, 1997.

SEC. 213. PRODUCTION FLEXIBILITY CONTRACT PAYMENTS.

The option under section 112(d)(3) of the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. 7212(d)(3)) shall be disregarded in determining the taxable year for which the payment for fiscal year 1999 under a production flexibility contract under subtitle B of title I of such Act is properly includible in gross income for purposes of the Internal Revenue Code of 1986.

Subtitle C—Increase in Volume Cap on Private Activity Bonds

SEC. 221. INCREASE IN VOLUME CAP ON PRIVATE ACTIVITY BONDS.

(a) IN GENERAL.—Subsection (d) of section 146 (relating to volume cap) is amended by striking paragraph (2), by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively, and by striking paragraph (1) and inserting the following new paragraph:

"(1) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of—

"(A) an amount equal to $75 multiplied by the State population, or

"(B) $225,000,000.

Subparagraph (B) shall not apply to any possession of the United States."

(b) CONFORMING AMENDMENT.—Sections 25(f)(3) and 42(h)(3)(E)(iii) are each amended by striking "section 146(d)(3)(C)" and inserting "section 146(d)(2)(C)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 1998.

TITLE III—EXTENSION AND MODIFICATION OF CERTAIN EXPIRING PROVISIONS

Subtitle A—Tax Provisions

SEC. 301. RESEARCH CREDIT.

(a) TEMPORARY EXTENSION.—

(1) IN GENERAL.—Paragraph (1) of section 41(h) (relating to termination) is amended—

(A) by striking "June 30, 1998" and inserting "February 29, 2000",

(B) by striking "24-month" and inserting "44-month", and

(C) by striking "24 months" and inserting "44 months".

(2) TECHNICAL AMENDMENT.—Subparagraph (D) of section 45C(b)(1) is amended by striking "June 30, 1998" and inserting "February 29, 2000".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred after June 30, 1998.

(b) INCREASE IN PERCENTAGES UNDER ALTERNATIVE INCREMENTAL CREDIT.—

(1) IN GENERAL.—Subparagraph (A) of section 41(c)(4) is amended—

(A) by striking "1.65 percent" and inserting "2.65 percent",

(B) by striking "2.2 percent" and inserting "3.2 percent", and

(C) by striking "2.75 percent" and inserting "3.75 percent".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after June 30, 1998.

SEC. 302. WORK OPPORTUNITY CREDIT.

(a) TEMPORARY EXTENSION.—Subparagraph (B) of section 51(c)(4) (relating to termination) is amended by striking "June 30, 1998" and inserting "February 29, 2000".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to individuals who begin work for the employer after June 30, 1998.

SEC. 303. WELFARE-TO-WORK CREDIT.

Subsection (f) of section 51A (relating to termination) is amended by striking "April 30, 1999" and inserting "February 29, 2000".

SEC. 304. CONTRIBUTIONS OF STOCK TO PRIVATE FOUNDATIONS; EXPANDED PUBLIC INSPECTION OF PRIVATE FOUNDATIONS' ANNUAL RETURNS.

(a) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK MADE PERMANENT.—

(1) IN GENERAL.—Paragraph (5) of section 170(e) is amended by striking subparagraph (D) (relating to termination).

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to contributions made after June 30, 1998.

(b) EXPANDED PUBLIC INSPECTION OF PRIVATE FOUNDATIONS' ANNUAL RETURNS, ETC.—

(1) IN GENERAL.—Section 6104 (relating to publicity of information required from certain exempt organizations and certain trusts) is amended by striking

subsections (d) and (e) and inserting after subsection (c) the following new subsection:

"(d) PUBLIC INSPECTION OF CERTAIN ANNUAL RETURNS AND APPLICATIONS FOR EXEMPTION.—

"(1) IN GENERAL.—In the case of an organization described in subsection (c) or (d) of section 501 and exempt from taxation under section 501(a)—

"(A) a copy of—

"(i) the annual return filed under section 6033 (relating to returns by exempt organizations) by such organization, and

"(ii) if the organization filed an application for recognition of exemption under section 501, the exempt status application materials of such organization,

shall be made available by such organization for inspection during regular business hours by any individual at the principal office of such organization and, if such organization regularly maintains 1 or more regional or district offices having 3 or more employees, at each such regional or district office, and

"(B) upon request of an individual made at such principal office or such a regional or district office, a copy of such annual return and exempt status application materials shall be provided to such individual without charge other than a reasonable fee for any reproduction and mailing costs.

The request described in subparagraph (B) must be made in person or in writing. If such request is made in person, such copy shall be provided immediately and, if made in writing, shall be provided within 30 days.

"(2) 3-YEAR LIMITATION ON INSPECTION OF RETURNS.—Paragraph (1) shall apply to an annual return filed under section 6033 only during the 3-year period beginning on the last day prescribed for filing such return (determined with regard to any extension of time for filing).

"(3) EXCEPTIONS FROM DISCLOSURE REQUIREMENT.—

"(A) NONDISCLOSURE OF CONTRIBUTORS, ETC.—Paragraph (1) shall not require the disclosure of the name or address of any contributor to the organization. In the case of an organization described in section 501(d), subparagraph (A) shall not require the disclosure of the copies referred to in section 6031(b) with respect to such organization.

"(B) NONDISCLOSURE OF CERTAIN OTHER INFORMATION.—Paragraph (1) shall not require the disclosure of any information if the Secretary withheld such information from public inspection under subsection (a)(1)(D).

"(4) LIMITATION ON PROVIDING COPIES.—Paragraph (1)(B) shall not apply to any request if, in accordance with regulations promulgated by the Secretary, the organization has made the requested documents widely available, or the Secretary determines, upon application by an organization, that such request is part of a harassment campaign and that compliance with such request is not in the public interest.

"(5) EXEMPT STATUS APPLICATION MATERIALS.—For purposes of paragraph (1), the term 'exempt status applicable materials' means the application for recognition of exemption under section 501 and any papers submitted in support of such application and any letter or other document issued by the Internal Revenue Service with respect to such application."

(2) CONFORMING AMENDMENTS.—

(A) Subsection (c) of section 6033 is amended by adding "and" at the end of paragraph (1), by striking paragraph (2), and by redesignating paragraph (3) as paragraph (2).

(B) Subparagraph (C) of section 6652(c)(1) is amended by striking "subsection (d) or (e)(1) of section 6104 (relating to public inspection of annual returns)" and inserting "section 6104(d) with respect to any annual return".

(C) Subparagraph (D) of section 6652(c)(1) is amended by striking "section 6104(e)(2) (relating to public inspection of applications for exemption)" and inserting "section 6104(d) with respect to any exempt status application materials (as defined in such section)".

(D) Section 6685 is amended by striking "or (e)".

(E) Section 7207 is amended by striking "or (e)".

(3) EFFECTIVE DATE.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this subsection shall apply to requests made after the later of December 31, 1998, or the 60th day after the Secretary of the Treasury first issues the regulations referred to such section 6104(d)(4) of the Internal Revenue Code of 1986, as amended by this section.

(B) PUBLICATION OF ANNUAL RETURNS.—Section 6104(d) of such Code, as in effect before the amendments made by this subsection, shall not apply to any return the due date for which is after the date such amendments take effect under subparagraph (A).

SEC. 305. SUBPART F EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) INCOME DERIVED FROM BANKING, FINANCING OR SIMILAR BUSINESSES.—Section 954(h) (relating to income derived in the active conduct of banking, financing, or similar businesses) is amended to read as follows:

"(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 qualified banking or financing income of an eligible controlled foreign corporation.

"(2) ELIGIBLE CONTROLLED FOREIGN CORPORATION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'eligible controlled foreign corporation' means a controlled foreign corporation which—

"(i) is predominantly engaged in the active conduct of a banking, financing, or similar business, and

"(ii) conducts substantial activity with respect to such business.

"(B) PREDOMINANTLY ENGAGED.—A controlled foreign corporation shall be treated as predominantly engaged in the active conduct of a banking, financing, or similar business if—

"(i) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,

"(ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or

"(iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations).

"(3) QUALIFIED BANKING OR FINANCING INCOME.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified banking or financing income' means income of an eligible controlled foreign corporation which—

"(i) is derived in the active conduct of a banking, financing, or similar business by—

"(I) such eligible controlled foreign corporation, or

"(II) a qualified business unit of such eligible controlled foreign corporation,

"(ii) is derived from 1 or more transactions—

"(I) with customers located in a country other than the United States, and

"(II) substantially all of the activities in connection with which are conducted directly by the corporation or unit in its home country, and

"(iii) is treated as earned by such corporation or unit in its home country for purposes of such country's tax laws.

"(B) LIMITATION ON NONBANKING AND NONSECURITIES BUSINESSES.—No income of an eligible controlled foreign corporation not described in clause (ii) or (iii) of paragraph (2)(B) (or of a qualified business unit of such corporation) shall be treated as qualified banking or financing income unless more than 30 percent of such corporation's or unit's gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons and which are located within such corporation's or unit's home country.

"(C) SUBSTANTIAL ACTIVITY REQUIREMENT FOR CROSS BORDER INCOME.—The term 'qualified banking or financing income' shall not include income derived from 1 or more transactions with customers located in a country other than the home country of the eligible controlled foreign corporation or a qualified business unit of such corporation unless such corporation or unit conducts substantial activity with respect to a banking, financing, or similar business in its home country.

"(D) DETERMINATIONS MADE SEPARATELY.—For purposes of this paragraph, the qualified banking or financing income of an eligible controlled foreign corporation and each qualified business unit of such corporation shall be determined separately for such corporation and each such unit by taking into account—

"(i) in the case of the eligible controlled foreign corporation, only items of income, deduction, gain, or loss and activities of such corporation not properly allocable or attributable to any qualified business unit of such corporation, and

"(ii) in the case of a qualified business unit, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

"(4) LENDING OR FINANCE BUSINESS.—For purposes of this subsection, the term 'lending or finance business' means the business of—

"(A) making loans,

"(B) purchasing or discounting accounts receivable, notes, or installment obligations,

"(C) engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets),

"(D) issuing letters of credit or providing guarantees,

"(E) providing charge and credit card services, or

"(F) rendering services or making facilities available in connection with activities described in subparagraphs (A) through (E) carried on by—

"(i) the corporation (or qualified business unit) rendering services or making facilities available, or

"(ii) another corporation (or qualified business unit of a corporation) which is a member of the same affiliated group (as defined in section 1504, but determined without regard to section 1504(b)(3)).

"(5) OTHER DEFINITIONS.—For purposes of this subsection—

"(A) CUSTOMER.—The term 'customer' means, with respect to any controlled foreign corporation or qualified business unit, any person which has a customer relationship with such corporation or unit and which is acting in its capacity as such.

"(B) HOME COUNTRY.—Except as provided in regulations—

"(i) CONTROLLED FOREIGN CORPORATION.—The term 'home country' means, with respect to any controlled foreign corporation, the country under the laws of which the corporation was created or organized.

"(ii) QUALIFIED BUSINESS UNIT.—The term 'home country' means, with respect to any qualified business unit, the country in which such unit maintains its principal office.

"(C) LOCATED.—The determination of where a customer is located shall be made under rules prescribed by the Secretary.

"(D) QUALIFIED BUSINESS UNIT.—The term 'qualified business unit' has the meaning given such term by section 989(a).

"(E) RELATED PERSON.—The term 'related person' has the meaning given such term by subsection (d)(3).

"(6) COORDINATION WITH EXCEPTION FOR DEALERS.—Paragraph (1) shall not apply to income described in subsection (c)(2)(C)(ii) of a dealer in securities (within the meaning of section 475) which is an eligible controlled foreign corporation described in paragraph (2)(B)(iii).

"(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and subsection (c)(2)(C)(ii)—

"(A) 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 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,

"(B) there shall be disregarded any item of income, gain, loss, or deduction of an entity which is not engaged in regular and continuous transactions with customers which are not related persons,

"(C) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions utilizing, or doing business with—

"(i) one or more entities in order to satisfy any home country requirement under this subsection, or

"(ii) a special purpose entity or arrangement, including a securitization, financing, or similar entity or arrangement,

if one of the principal purposes of such transaction or series of transactions is qualifying income or gain for the exclusion under this subsection, and

"(D) a related person, an officer, a director, or an employee with respect to any controlled foreign corporation (or qualified business unit) which would otherwise be treated as a customer of such corporation or unit with respect to any transaction shall not be so treated if a principal purpose of such transaction is to satisfy any requirement of this subsection.

"(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, subsection (c)(1)(B)(i), subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2).

"(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to the first taxable year of a foreign corporation beginning after December 31, 1998, and before January 1, 2000, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends."

(b) INCOME DERIVED FROM INSURANCE BUSINESS.—

(1) INCOME ATTRIBUTABLE TO ISSUANCE OR REINSURANCE.—

(A) IN GENERAL.—Section 953(a) (defining insurance income) is amended to read as follows:

"(a) INSURANCE INCOME.—

"(1) IN GENERAL.—For purposes of section 952(a)(1), the term 'insurance income' means any income which—

"(A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and

"(B) would (subject to the modifications provided by subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.

"(2) EXCEPTION.—Such term shall not include any exempt insurance income (as defined in subsection (e))."

(B) EXEMPT INSURANCE INCOME.—Section 953 (relating to insurance income) is amended by adding at the end the following new subsection:

"(e) EXEMPT INSURANCE INCOME.—For purposes of this section—

"(1) EXEMPT INSURANCE INCOME DEFINED.—

"(A) IN GENERAL.—The term 'exempt insurance income' means income derived by a qualifying insurance company which—

"(i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and

"(ii) is treated as earned by such company or branch in its home country for purposes of such country's tax laws.

"(B) EXCEPTION FOR CERTAIN ARRANGEMENTS.—Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.

"(C) DETERMINATIONS MADE SEPARATELY.—For purposes of this subsection and section 954(i), the exempt insurance income and exempt contracts of a qualifying insurance company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—

"(i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and

"(ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

"(2) EXEMPT CONTRACT.—

"(A) IN GENERAL.—The term 'exempt contract' means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.

"(B) MINIMUM HOME COUNTRY INCOME REQUIRED.—

"(i) IN GENERAL.—No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—

"(I) which cover applicable home country risks, and

"(II) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)).

"(ii) APPLICABLE HOME COUNTRY RISKS.—The term 'applicable home country risks' means risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.

"(C) SUBSTANTIAL ACTIVITY REQUIREMENTS FOR CROSS BORDER RISKS.—A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—

"(i) conducts substantial activity with respect to an insurance business in its home country, and

"(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.

"(3) QUALIFYING INSURANCE COMPANY.—The term 'qualifying insurance company' means any controlled foreign corporation which—

"(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country,

"(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by such controlled foreign corporation and each of its qualifying insurance company branches of contracts—

"(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and

"(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)),

except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country's tax laws, and

"(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

"(4) QUALIFYING INSURANCE COMPANY BRANCH.—The term 'qualifying insurance company branch' means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—

"(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country, and

"(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

"(5) LIFE INSURANCE OR ANNUITY CONTRACT.—For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

"(A) such contract is regulated as a life insurance or annuity contract by the corporation's or unit's home country, and

"(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

"(6) HOME COUNTRY.—For purposes of this subsection, except as provided in regulations—

"(A) CONTROLLED FOREIGN CORPORATION.—The term 'home country' means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.

"(B) QUALIFIED BUSINESS UNIT.—The term 'home country' means, with respect to a qualified business unit (as defined in section 989(a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954(d)(3)) in such country.

"(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and section 954(i)—

"(A) the rules of section 954(h)(7) (other than subparagraph (B) thereof) shall apply,

"(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,

"(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954(i),

"(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—

"(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or

"(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and file such reports, with respect to such contract as the Secretary may require,

"(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and

"(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954(d)(3)).

For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.

"(8) COORDINATION WITH SUBSECTION (c).—In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954(i).

"(10) APPLICATION.—This subsection and section 954(i) shall apply only to the first taxable year of a foreign corporation beginning after December 31, 1998, and before January 1, 2000, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.

"(11) CROSS REFERENCE.—

"For income exempt from foreign personal holding company income, see section 954(i)."

(2) EXEMPTION FROM FOREIGN PERSONAL HOLDING COMPANY INCOME.—Section 954 (defining foreign base company income) is amended by adding at the end the following new subsection:

"(i) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF INSURANCE BUSINESS.—

"(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified insurance income of a qualifying insurance company.

"(2) QUALIFIED INSURANCE INCOME.—The term 'qualified insurance income' means income of a qualifying insurance company which is—

"(A) 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 or a qualifying insurance company branch of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in the manner prescribed under paragraph (4)), or

"(B) 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 or a qualifying insurance company branch of an amount of its assets allocable to exempt contracts equal to—

"(i) in the case of 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 life insurance or annuity contracts, 10 percent of the reserves described in subparagraph (A) for such contracts.

"(3) PRINCIPLES FOR DETERMINING INSURANCE INCOME.—Except as provided by the Secretary, for purposes of subparagraphs (A) and (B) of paragraph (2)—

"(A) in the case of any contract which is a separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract shall be allocable only to such contract, and

"(B) income not allocable under subparagraph (A) shall be allocated ratably among contracts not described in subparagraph (A).

"(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (2)(A)—

"(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company or a qualifying insurance company branch 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 or branch were subject to tax under subchapter L, except that—

"(i) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate, and

"(ii) such company or branch shall use the appropriate foreign loss payment pattern.

"(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—The amount of the reserve of a qualifying insurance company or qualifying insurance company branch for any life insurance or annuity contract shall be equal to the greater of—

"(i) the net surrender value of such contract (as defined in section 807(e)(1)(A)), or

"(ii) the reserve determined under paragraph (5).

"(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 statement reserves (less any catastrophe, deficiency, equalization, or similar reserves).

"(5) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined in the same manner as it would be determined if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L, except that in applying such subchapter—

"(A) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate,

"(B) the highest assumed interest rate permitted to be used in determining foreign statement reserves shall be substituted for the prevailing State assumed interest rate, and

"(C) tables for mortality and morbidity which reasonably reflect the current mortality and morbidity risks in the company's or branch's home country shall be substituted for the mortality and morbidity tables otherwise used for such subchapter.

The Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for 1 or more of its qualifying insurance company branches when appropriate.

"(6) DEFINITIONS.—For purposes of this subsection, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term by section 953."

(3) RESERVES.—Section 953(b) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) Reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i)."

(c) SPECIAL RULES FOR DEALERS.—Section 954(c)(2)(C) is amended to read as follows:

"(C) EXCEPTION FOR DEALERS.—Except as provided by regulations, in the case of a regular dealer in property which is property described in 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 company income—

"(i) any item of income, gain, deduction, or loss (other than any item described in subparagraph (A), (E), or (G) of paragraph (1)) from any transaction (including hedging transactions) entered into in the ordinary course of such dealer's trade or business as such a dealer, and

"(ii) if such dealer is a dealer in securities (within the meaning of section 475), any interest or dividend or equivalent amount described in subparagraph (E) or (G) of paragraph (1) from any transaction (including any hedging transaction or transaction described in section 956(c)(2)(J)) entered into in the ordinary course of such dealer's trade or business as such a dealer in securities, but only if the income from the transaction is attributable to activities of the dealer in the country under the laws of which the dealer is created or organized (or in the case of a qualified business unit described in section 989(a), is attributable to activities of the unit in the country in which the unit both maintains its principal office and conducts substantial business activity)."

(d) EXEMPTION FROM FOREIGN BASE COMPANY SERVICES INCOME.—Paragraph (2) of section 954(e) is amended by inserting "or" at the end of subparagraph (A), by striking ", or" at the end of subparagraph (B) and inserting a period, by striking subparagraph (C), and by adding at the end the following new flush sentence:

"Paragraph (1) shall also not apply to income which is exempt insurance income (as defined in section 953(e)) or which is not treated as foreign personal holding income by reason of subsection (c)(2)(C)(ii), (h), or (i)."

(e) EXEMPTION FOR GAIN.—Section 954(c)(1)(B)(i) (relating to net gains from certain property transactions) is amended by inserting "other than property which gives rise to income not treated as foreign personal holding company income by reason of subsection (h) or (i) for the taxable year" before the comma at the end.

Subtitle B—Generalized System of Preferences

SEC. 311. EXTENSION OF GENERALIZED SYSTEM OF PREFERENCES.

(a) EXTENSION OF DUTY-FREE TREATMENT UNDER SYSTEM.—Section 505 of the Trade Act of 1974 (29 U.S.C. 2465) is amended by striking "June 30, 1998" and inserting "February 29, 2000".

(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), any entry—

(A) of an article to which duty-free treatment under title V of the Trade Act of 1974 would have applied if such title had been in effect during the period beginning on July 1, 1998, and ending on the day before the date of the enactment of this Act, and

(B) that was made after June 30, 1998, 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 IV—REVENUE OFFSET

SEC. 401. TREATMENT OF CERTAIN DEDUCTIBLE LIQUIDATING DISTRIBUTIONS OF REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.

(a) IN GENERAL.—Section 332 (relating to complete liquidations of subsidiaries) is amended by adding at the end the following new subsection:

"(c) DEDUCTIBLE LIQUIDATING DISTRIBUTIONS OF REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—If a corporation receives a distribution from a regulated investment company or a real estate investment trust which is considered under subsection (b) as being in complete liquidation of such company or trust, then, notwithstanding any other provision of this chapter, such corporation shall recognize and treat as a dividend from such company or trust an amount equal to the deduction for dividends paid allowable to such company or trust by reason of such distribution.".

(b) CONFORMING AMENDMENTS.—

(1) The material preceding paragraph (1) of section 332(b) is amended by striking "subsection (a)" and inserting "this section".

(2) Paragraph (1) of section 334(b) is amended by striking "section 332(a)" and inserting "section 332".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after May 21, 1998.

TITLE V—TECHNICAL CORRECTIONS

SEC. 501. DEFINITIONS; COORDINATION WITH OTHER TITLES.

(a) DEFINITIONS.—For purposes of this title—

(1) 1986 CODE.—The term "1986 Code" means the Internal Revenue Code of 1986.

(2) 1998 ACT.—The term "1998 Act" means the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206).

(3) 1997 ACT.—The term "1997 Act" means the Taxpayer Relief Act of 1997 (Public Law 105–34).

(b) 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. 502. AMENDMENTS RELATED TO INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998.

(a) AMENDMENT RELATED TO SECTION 1101 OF 1998 ACT.—Paragraph (5) of section 6103(h) of the 1986 Code, as added by section 1101(b) of the 1998 Act, is redesignated as paragraph (6).

(b) AMENDMENT RELATED TO SECTION 3001 OF 1998 ACT.—Paragraph (2) of section 7491(a) of the 1986 Code is amended by adding at the end the following flush sentence:

"Subparagraph (C) shall not apply to any qualified revocable trust (as defined in section 645(b)(1)) with respect to liability for tax for any taxable year ending after the date of the decedent's death and before the applicable date (as defined in section 645(b)(2)).".

(c) AMENDMENTS RELATED TO SECTION 3201 OF 1998 ACT.—

(1) Section 7421(a) of the 1986 Code is amended by striking "6015(d)" and inserting "6015(e)".

(2) Subparagraph (A) of section 6015(e)(3) is amended by striking "of this section" and inserting "of subsection (b) or (f)".

(d) AMENDMENT RELATED TO SECTION 3301 OF 1998 ACT.—Paragraph (2) of section 3301(c) of the 1998 Act is amended by striking "The amendments" and inserting "Subject to any applicable statute of limitation not having expired with regard to either a tax underpayment or a tax overpayment, the amendments".

(e) AMENDMENT RELATED TO SECTION 3401 OF 1998 ACT.—Section 3401(c) of the 1998 Act is amended—

(1) in paragraph (1), by striking "7443(b)" and inserting "7443A(b)"; and

(2) in paragraph (2), by striking "7443(c)" and inserting "7443A(c)".

(f) AMENDMENT RELATED TO SECTION 3433 OF 1998 ACT.—Section 7421(a) of the 1986 Code is amended by inserting "6331(i)," after "6246(b),".

(g) AMENDMENT RELATED TO SECTION 3708 OF 1998 ACT.—Subparagraph (A) of section 6103(p)(3) of the 1986 Code is amended by inserting "(f)(5)," after "(c), (e),".

(h) AMENDMENT RELATED TO SECTION 5001 OF 1998 ACT.—

(1) Subparagraph (B) of section 1(h)(13) of the 1986 Code is amended by striking "paragraph (7)(A)" and inserting "paragraph (7)(A)(i)".

(2)(A) Subparagraphs (A)(i)(II), (A)(ii)(II), and (B)(ii) of section 1(h)(13) of the 1986 Code shall not apply to any distribution after December 31, 1997, by a regulated investment company or a real estate investment trust with respect to—

(i) gains and losses recognized directly by such company or trust, and

(ii) amounts properly taken into account by such company or trust by reason of holding (directly or indirectly) an interest in another such company or trust to the extent that such subparagraphs did not apply to such other company or trust with respect to such amounts.

(B) Subparagraph (A) shall not apply to any distribution which is treated under section 852(b)(7) or 857(b)(8) of the 1986 Code as received on December 31, 1997.

(C) For purposes of subparagraph (A), any amount which is includible in gross income of its shareholders under section 852(b)(3)(D) or 857(b)(3)(D) of the 1986 Code after December 31, 1997, shall be treated as distributed after such date.

(D)(i) For purposes of subparagraph (A), in the case of a qualified partnership with respect to which a regulated investment company meets the holding requirement of clause (iii)—

(I) the subparagraphs referred to in subparagraph (A) shall not apply to gains and losses recognized directly by such partnership for purposes of determining such company's distributive share of such gains and losses, and

(II) such company's distributive share of such gains and losses (as so determined) shall be treated as recognized directly by such company.

The preceding sentence shall apply only if the qualified partnership provides the company with written documentation of such distributive share as so determined.

(ii) For purposes of clause (i), the term "qualified partnership" means, with respect to a regulated investment company, any partnership if—

(I) the partnership is an investment company registered under the Investment Company Act of 1940,

(II) the regulated investment company is permitted to invest in such partnership by reason of section 12(d)(1)(E) of such Act or an exemptive order of the Securities and Exchange Commission under such section, and

(III) the regulated investment company and the partnership have the same taxable year.

(iii) A regulated investment company meets the holding requirement of this clause with respect to a qualified partnership if (as of January 1, 1998)—

(I) the value of the interests of the regulated investment company in such partnership is 35 percent or more of the value of such company's total assets, or

(II) the value of the interests of the regulated investment company in such partnership and all other qualified partnerships is 90 percent or more of the value of such company's total assets.

(i) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the 1998 Act to which they relate.

SEC. 503. AMENDMENTS RELATED TO TAXPAYER RELIEF ACT OF 1997.

(a) AMENDMENT RELATED TO SECTION 202 OF 1997 ACT.—Paragraph (2) of section 163(h) of the 1986 Code is amended by striking "and" at the end of subparagraph (D), by striking the period at the end of subparagraph (E) and inserting ", and", and by adding at the end the following new subparagraph:

"(F) any interest allowable as a deduction under section 221 (relating to interest on educational loans)."

(b) PROVISION RELATED TO SECTION 311 OF 1997 ACT.—In the case of any capital gain distribution made after 1997 by a trust to which section 664 of the 1986 Code applies with respect to amounts properly taken into account by such trust during 1997, paragraphs (5)(A)(i)(I), (5)(A)(ii)(I), and (13)(A) of section 1(h) of the 1986 Code (as in effect for taxable years ending on December 31, 1997) shall not apply.

(c) AMENDMENT RELATED TO SECTION 506 OF 1997 ACT.—

(1) Section 2001(f)(2) of the 1986 Code is amended by adding at the end the following:

"For purposes of subparagraph (A), the value of an item shall be treated as shown on a return if the item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.".

(2) Paragraph (9) of section 6501(c) of the 1986 Code is amended by striking the last sentence.

(d) AMENDMENTS RELATED TO SECTION 904 OF 1997 ACT.—

(1) Paragraph (1) of section 9510(c) of the 1986 Code is amended to read as follows:

"(1) IN GENERAL.—Amounts in the Vaccine Injury Compensation Trust Fund shall be available, as provided in appropriation Acts, only for—

"(A) the payment of compensation under subtitle 2 of title XXI of the Public Health Service Act (as in effect on August 5, 1997) for vaccine-related injury or death with respect to any vaccine—

"(i) which is administered after September 30, 1988, and

"(ii) which is a taxable vaccine (as defined in section 4132(a)(1)) at the time compensation is paid under such subtitle 2, or

"(B) the payment of all expenses of administration (but not in excess of $9,500,000 for any fiscal year) incurred by the Federal Government in administering such subtitle.".

(2) Section 9510(b) of the 1986 Code is amended by adding at the end the following new paragraph:

"(3) LIMITATION ON TRANSFERS TO VACCINE INJURY COMPENSATION TRUST FUND.—No amount may be appropriated to the Vaccine Injury Compensation Trust Fund on and after the date of any expenditure from the Trust Fund which is not permitted by this section. The determination of whether an expenditure is so permitted shall be made without regard to—

"(A) any provision of law which is not contained or referenced in this title or in a revenue Act, and

"(B) whether such provision of law is a subsequently enacted provision or directly or indirectly seeks to waive the application of this paragraph.".

(e) AMENDMENTS RELATED TO SECTION 915 OF 1997 ACT.—

(1) Section 915 of the Taxpayer Relief Act of 1997 is amended—

(A) in subsection (b), by inserting "or 1998" after "1997", and

(B) by amending subsection (d) to read as follows:

"(d) EFFECTIVE DATE.—This section shall apply to taxable years ending with or within calendar year 1997.".

(2) Paragraph (2) of section 6404(h) of the 1986 Code is amended by inserting "Robert T. Stafford" before "Disaster".

(f) AMENDMENTS RELATED TO SECTION 1012 OF 1997 ACT.—

(1) Paragraph (2) of section 351(c) of the 1986 Code, as amended by section 6010(c) of the 1998 Act, is amended by inserting ", or the fact that the corporation whose stock was distributed issues additional stock," after "dispose of part or all of the distributed stock".

(2) Clause (ii) of section 368(a)(2)(H) of the 1986 Code, as amended by section 6010(c) of the 1998 Act, is amended by inserting ", or the fact that the corporation whose stock was distributed issues additional stock," after "dispose of part or all of the distributed stock".

(g) AMENDMENT RELATED TO SECTION 1082 OF 1997 ACT.—Subparagraph (F) of section 172(b)(1) of the 1986 Code is amended by adding at the end the following new clause:

"(iv) COORDINATION WITH PARAGRAPH (2).—For purposes of applying paragraph (2), an eligible loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated."

(h) AMENDMENT RELATED TO SECTION 1084 OF 1997 ACT.—Paragraph (3) of section 264(f) of the 1986 Code is amended by adding at the end the following flush sentence:

"If the amount described in subparagraph (A) with respect to any policy or contract does not reasonably approximate its actual value, the amount taken into account under subparagraph (A) shall be the greater of the amount of the insurance company liability or the insurance company reserve with respect to such policy or contract (as determined for purposes of the annual statement approved by the National Association of Insurance Commissioners) or shall be such other amount as is determined by the Secretary."

(i) AMENDMENT RELATED TO SECTION 1205 OF 1997 ACT.—Paragraph (2) of section 6311(d) of the 1986 Code is amended by striking "under such contracts" in the last sentence and inserting "under any such contract for the use of credit or debit cards for the payment of taxes imposed by subtitle A".

(j) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the provisions of the Taxpayer Relief Act of 1997 to which they relate.

SEC. 504. AMENDMENTS RELATED TO TAX REFORM ACT OF 1984.

(a) IN GENERAL.—Subparagraph (C) of section 172(d)(4) of the 1986 Code is amended to read as follows:

"(C) any deduction for casualty or theft losses allowable under paragraph (2) or (3) of section 165(c) shall be treated as attributable to the trade or business; and".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (3) of section 67(b) of the 1986 Code is amended by striking "for losses described in subsection (c)(3) or (d) of section 165" and inserting "for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d)".

(2) Paragraph (3) of section 68(c) of the 1986 Code is amended by striking "for losses described in subsection (c)(3) or (d) of section 165" and inserting "for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d)".

(3) Paragraph (1) of section 873(b) is amended to read as follows:

"(1) LOSSES.—The deduction allowed by section 165 for casualty or theft losses described in paragraph (2) or (3) of section 165(c), but only if the loss is of property located within the United States."

(c) EFFECTIVE DATES.—

(1) The amendments made by subsections (a) and (b)(3) shall apply to taxable years beginning after December 31, 1983.

(2) The amendment made by subsection (b)(1) shall apply to taxable years beginning after December 31, 1986.

(3) The amendment made by subsection (b)(2) shall apply to taxable years beginning after December 31, 1990.

SEC. 505. OTHER AMENDMENTS.

(a) AMENDMENTS RELATED TO SECTION 6103 OF 1986 CODE.—

(1) Subsection (j) of section 6103 of the 1986 Code is amended by adding at the end the following new paragraph:

"(5) DEPARTMENT OF AGRICULTURE.—Upon request in writing by the Secretary of Agriculture, the Secretary shall furnish such returns, or return information reflected thereon, as the Secretary may prescribe by regulation to officers and employees of the Department of Agriculture whose official duties require access to such returns or information for the purpose of, but only to the extent necessary in, structuring, preparing, and conducting the census of agriculture pursuant to the Census of Agriculture Act of 1997 (Public Law 105–113).".

(2) Paragraph (4) of section 6103(p) of the 1986 Code is amended by striking "(j)(1) or (2)" in the material preceding subparagraph (A) and in subparagraph (F) and inserting "(j)(1), (2), or (5)".

(3) The amendments made by this subsection shall apply to requests made on or after the date of the enactment of this Act.

(b) AMENDMENT RELATED TO SECTION 9004 OF TRANSPORTATION EQUITY ACT FOR THE 21ST CENTURY.—

(1) Paragraph (2) of section 9503(f) of the 1986 Code is amended to read as follows:

"(2) notwithstanding section 9602(b), obligations held by such Fund after September 30, 1998, shall be obligations of the United States which are not interest-bearing."

(2) The amendment made by paragraph (1) shall take effect on October 1, 1998.

(c) CLERICAL AMENDMENTS.—

(1) Clause (i) of section 51(d)(6)(B) of the 1986 Code is amended by striking "rehabilitation plan" and inserting "plan for employment". The reference to plan for employment in such clause shall be treated as including a reference to the rehabilitation plans referred to in such clause as in effect before the amendment made by the preceding sentence.

(2) Subparagraphs (C) and (D) of section 6693(a)(2) of the 1986 Code are each amended by striking "Section" and inserting "section".

TITLE VI—AMERICAN COMMUNITY RENEWAL ACT OF 1998

SEC. 601. SHORT TITLE.

This title may be cited as the "American Community Renewal Act of 1998".

SEC. 602. DESIGNATION OF AND TAX INCENTIVES FOR RENEWAL COMMUNITIES.

(a) IN GENERAL.—Chapter 1 is amended by adding at the end the following new subchapter:

"Subchapter X—Renewal Communities

"Part I. Designation.
"Part II. Renewal community capital gain; renewal community business.
"Part III. Family development accounts.
"Part IV. Additional incentives.

"PART I—DESIGNATION

"Sec. 1400E. Designation of renewal communities.

"SEC. 1400E. DESIGNATION OF RENEWAL COMMUNITIES.

"(a) DESIGNATION.—

"(1) DEFINITIONS.—For purposes of this title, the term 'renewal community' means any area—

"(A) which is nominated by one or more local governments and the State or States in which it is located for designation as a renewal community (hereinafter in this section referred to as a 'nominated area'), and

"(B) which the Secretary of Housing and Urban Development designates as a renewal community, after consultation with—

"(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury; the Director of the Office of Management and Budget; and the Administrator of the Small Business Administration, and

"(ii) in the case of an area on an Indian reservation, the Secretary of the Interior.

"(2) NUMBER OF DESIGNATIONS.—

"(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 20 nominated areas as renewal communities.

"(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under paragraph (1), at least 4 must be areas—

"(i) which are within a local government jurisdiction or jurisdictions with a population of less than 50,000,

"(ii) which are outside of a metropolitan statistical area (within the meaning of section 143(k)(2)(B)), or

"(iii) which are determined by the Secretary of Housing and Urban Development, after consultation with the Secretary of Commerce, to be rural areas.

"(3) AREAS DESIGNATED BASED ON DEGREE OF POVERTY, ETC.—

"(A) IN GENERAL.—Except as otherwise provided in this section, the nominated areas designated as renewal communities under this subsection shall be those nominated areas with the highest average ranking with respect to the criteria described in subparagraphs (B), (C), and (D) of subsection (c)(3). For purposes of the preceding sentence, an area shall be ranked within each such criterion on the basis of the amount by which the area exceeds such criterion, with the area which exceeds such criterion by the greatest amount given the highest ranking.

"(B) EXCEPTION WHERE INADEQUATE COURSE OF ACTION, ETC.—An area shall not be designated under subparagraph (A) if the Secretary of Housing and Urban Development determines that the course of action described in subsection (d)(2) with respect to such area is inadequate.

"(C) PRIORITY FOR EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES WITH RESPECT TO FIRST HALF OF DESIGNATIONS.—With respect to the first 10 designations made under this section—

"(i) 10 shall be chosen from nominated areas which are empowerment zones or enterprise communities (and are otherwise eligible for designation under this section), and

"(ii) of such 10, 2 shall be areas described in paragraph (2)(B).

"(4) LIMITATION ON DESIGNATIONS.—

"(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

"(i) the procedures for nominating an area under paragraph (1)(A),

"(ii) the parameters relating to the size and population characteristics of a renewal community, and "(iii) the manner in which nominated areas will be evaluated based on the criteria specified in subsection (d).

"(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate nominated areas as renewal communities only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

"(C) PROCEDURAL RULES.—The Secretary of Housing and Urban Development shall not make any designation of a nominated area as a renewal community under paragraph (2) unless—

"(i) the local governments and the States in which the nominated area is located have the authority—

"(I) to nominate such area for designation as a renewal community,

"(II) to make the State and local commitments described in subsection (d), and

"(III) to provide assurances satisfactory to the Secretary of Housing and Urban Development that such commitments will be fulfilled,

"(ii) a nomination regarding such area is submitted in such a manner and in such form, and contains such information, as the Secretary of Housing and Urban Development shall by regulation prescribe, and

"(iii) the Secretary of Housing and Urban Development determines that any information furnished is reasonably accurate.

"(5) NOMINATION PROCESS FOR INDIAN RESERVATIONS.—For purposes of this subchapter, in the case of a nominated area on an Indian reservation, the reservation governing body (as determined by the Secretary of the Interior) shall be treated as being both the State and local governments with respect to such area.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

"(1) IN GENERAL.—Any designation of an area as a renewal community shall remain in effect during the period beginning on the date of the designation and ending on the earliest of—

"(A) December 31, 2006,

"(B) the termination date designated by the State and local governments in their nomination, or

"(C) the date the Secretary of Housing and Urban Development revokes such designation.

"(2) REVOCATION OF DESIGNATION.—The Secretary of Housing and Urban Development may revoke the designation under this section of an area if such Secretary determines that the local government or the State in which the area is located—

"(A) has modified the boundaries of the area, or

"(B) is not complying substantially with, or fails to make progress in achieving, the State or local commitments, respectively, described in subsection (d).

"(c) AREA AND ELIGIBILITY REQUIREMENTS.—

"(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate a nominated area as a renewal community under subsection (a) only if the area meets the requirements of paragraphs (2) and (3) of this subsection.

"(2) AREA REQUIREMENTS.—A nominated area meets the requirements of this paragraph if—

"(A) the area is within the jurisdiction of one or more local governments,

"(B) the boundary of the area is continuous, and

"(C) the area—

"(i) has a population, of at least—

"(I) 4,000 if any portion of such area (other than a rural area described in subsection (a)(2)(B)(i)) is located within a metropolitan statistical area (within the meaning of section 143(k)(2)(B)) which has a population of 50,000 or greater, or

"(II) 1,000 in any other case, or

"(ii) is entirely within an Indian reservation (as determined by the Secretary of the Interior).

"(3) ELIGIBILITY REQUIREMENTS.—A nominated area meets the requirements of this paragraph if the State and the local governments in which it is located certify (and the Secretary of Housing and Urban Development, after such review of supporting data as he deems appropriate, accepts such certification) that—

"(A) the area is one of pervasive poverty, unemployment, and general distress,

"(B) the unemployment rate in the area, as determined by the most recent available data, was at least 1½ times the national unemployment rate for the period to which such data relate,

"(C) the poverty rate for each population census tract within the nominated area is at least 20 percent, and

"(D) in the case of an urban area, at least 70 percent of the households living in the area have incomes below 80 percent of the median income of households within the jurisdiction of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974).

"(4) CONSIDERATION OF HIGH INCIDENCE OF CRIME.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, the extent to which such areas have a high incidence of crime.

"(5) CONSIDERATION OF COMMUNITIES IDENTIFIED IN GAO STUDY.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, if the area has census tracts identified in the May 12, 1998, report of the Government Accounting Office regarding the identification of economically distressed areas.

"(d) REQUIRED STATE AND LOCAL COMMITMENTS.—

"(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate any nominated area as a renewal community under subsection (a) only if—

"(A) the local government and the State in which the area is located agree in writing that, during any period during which the area is a renewal community, such governments will follow a specified course of action which meets the requirements of paragraph (2) and is designed to reduce the various burdens borne by employers or employees in such area, and

"(B) the economic growth promotion requirements of paragraph (3) are met.

"(2) COURSE OF ACTION.—

"(A) IN GENERAL.—A course of action meets the requirements of this paragraph if such course of action is a written document, signed by a State (or local government) and neighborhood organizations, which evidences a partnership between such State or government and community-based organizations and which commits each signatory to specific and measurable goals, actions, and timetables. Such course of action shall include at least five of the following:

"(i) A reduction of tax rates or fees applying within the renewal community.

"(ii) An increase in the level of efficiency of local services within the renewal community.

"(iii) Crime reduction strategies, such as crime prevention (including the provision of such services by nongovernmental entities).

"(iv) Actions to reduce, remove, simplify, or streamline governmental requirements applying within the renewal community.

"(v) Involvement in the program by private entities, organizations, neighborhood organizations, and community groups, particularly those in the renewal community, including a commitment from such private entities to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents from the renewal community.

"(vi) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a governmental entity.

"(vii) The gift (or sale at below fair market value) of surplus real property (such as land, homes, and commercial or industrial structures) in the renewal community to neighborhood organizations, community development corporations, or private companies.

"(B) RECOGNITION OF PAST EFFORTS.—For purposes of this section, in evaluating the course of action agreed to by any State or local government, the Secretary of Housing and Urban Development shall take into account the past efforts of such State or local government in reducing the various burdens borne by employers and employees in the area involved.

"(3) ECONOMIC GROWTH PROMOTION REQUIREMENTS.—The economic growth promotion requirements of this paragraph are met with respect to a nominated area if the local government and the State in which such area is located certify in writing that such government and State, respectively, have repealed or otherwise will not enforce within the area, if such area is designated as a renewal community—

"(A) licensing requirements for occupations that do not ordinarily require a professional degree,

"(B) zoning restrictions on home-based businesses which do not create a public nuisance,

"(C) permit requirements for street vendors who do not create a public nuisance,

"(D) zoning or other restrictions that impede the formation of schools or child care centers, and

"(E) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling,

except to the extent that such regulation of businesses and occupations is necessary for and well-tailored to the protection of health and safety.

"(e) COORDINATION WITH TREATMENT OF EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES.—For purposes of this title, if there are in effect with respect to the same area both—

"(1) a designation as a renewal community, and

"(2) a designation as an empowerment zone or enterprise community,

both of such designations shall be given full effect with respect to such area.

"(f) DEFINITIONS AND SPECIAL RULES.—For purposes of this subchapter—

"(1) GOVERNMENTS.—If more than one government seeks to nominate an area as a renewal community, any reference to, or requirement of, this section shall apply to all such governments.

"(2) STATE.—The term 'State' includes Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States.

"(3) LOCAL GOVERNMENT.—The term 'local government' means—

"(A) any county, city, town, township, parish, village, or other general purpose political subdivision of a State,

"(B) any combination of political subdivisions described in subparagraph (A) recognized by the Secretary of Housing and Urban Development, and

"(C) the District of Columbia.

"(4) APPLICATION OF RULES RELATING TO CENSUS TRACTS AND CENSUS DATA.—The rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

"PART II—RENEWAL COMMUNITY CAPITAL GAIN; RENEWAL COMMUNITY BUSINESS

"Sec. 1400F. Renewal community capital gain.
"Sec. 1400G. Renewal community business defined.

"SEC. 1400F. RENEWAL COMMUNITY CAPITAL GAIN.

"(a) GENERAL RULE.—Gross income does not include any qualified capital gain recognized on the sale or exchange of a qualified community asset held for more than 5 years.

"(b) QUALIFIED COMMUNITY ASSET.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified community asset' means—

"(A) any qualified community stock,

"(B) any qualified community partnership interest, and

"(C) any qualified community business property.

"(2) QUALIFIED COMMUNITY STOCK.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified community stock' means any stock in a domestic corporation if—

"(i) such stock is acquired by the taxpayer after December 31, 1999, and before January 1, 2007, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

"(ii) as of the time such stock was issued, such corporation was a renewal community business (or, in the case of a new corporation, such corporation was being organized for purposes of being a renewal community business), and "(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a renewal community business.

"(B) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

"(3) QUALIFIED COMMUNITY PARTNERSHIP INTEREST.—The term 'qualified community partnership interest' means any interest in a partnership if—

"(A) such interest is acquired by the taxpayer after December 31, 1999, and before January 1, 2007,

"(B) as of the time such interest was acquired, such partnership was a renewal community business (or, in the case of a new partnership, such partnership was being organized for purposes of being a renewal community business), and

"(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a renewal community business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

"(4) QUALIFIED COMMUNITY BUSINESS PROPERTY.—

"(A) IN GENERAL.—The term 'qualified community 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, 1999, and before January 1, 2007,

"(ii) the original use of such property in the renewal community 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 renewal community business of the taxpayer.

"(B) SPECIAL RULE FOR SUBSTANTIAL IMPROVEMENTS.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as satisfied with respect to—

"(i) property which is substantially improved (within the meaning of section 1400B(b)(4)(B)(ii)) by the taxpayer before January 1, 2007, and

"(ii) any land on which such property is located.

"(c) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (b), and subsections (e), (f), and (g), of section 1400B shall apply for purposes of this section.

"SEC. 1400G. RENEWAL COMMUNITY BUSINESS DEFINED.

"For purposes of this part, the term 'renewal community business' means any entity or proprietorship which would be a qualified business entity or qualified proprietorship under section 1397B if—

"(1) references to renewal communities were substituted for references to empowerment zones in such section; and

"(2) '80 percent' were substituted for '50 percent' in subsections (b)(2) and (c)(1) of such section.

"PART III—FAMILY DEVELOPMENT ACCOUNTS

"Sec. 1400H. Family development accounts for renewal community EITC recipients.
"Sec. 1400I. Demonstration program to provide matching contributions to family development accounts in certain renewal communities.
"Sec. 1400J. Designation of earned income tax credit payments for deposit to family development account.

"SEC. 1400H. FAMILY DEVELOPMENT ACCOUNTS FOR RENEWAL COMMUNITY EITC RECIPIENTS.

"(a) ALLOWANCE OF DEDUCTION.—

"(1) IN GENERAL.—There shall be allowed as a deduction—

"(A) in the case of a qualified individual, the amount paid in cash for the taxable year by such individual to any family development account for such individual's benefit, and

"(B) in the case of any person other than a qualified individual, the amount paid in cash for the taxable year by such person to any family development account for the benefit of a qualified individual but only if the amount so paid is designated for purposes of this section by such individual.

No deduction shall be allowed under this paragraph for any amount deposited in a family development account under section 1400I (relating to demonstration program to provide matching amounts in renewal communities).

"(2) LIMITATION.—

"(A) IN GENERAL.—The amount allowable as a deduction to any individual for any taxable year by reason of paragraph (1)(A) shall not exceed the lesser of—

"(i) $2,000, or

"(ii) an amount equal to the compensation includible in the individual's gross income for such taxable year.

"(B) PERSONS DONATING TO FAMILY DEVELOPMENT ACCOUNTS OF OTHERS.—The amount which may be designated under paragraph (1)(B) by any qualified individual for any taxable year of such individual shall not exceed $1,000.

"(3) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—Rules similar to rules of section 219(c) shall apply to the limitation in paragraph (2)(A).

"(4) COORDINATION WITH IRA'S.—No deduction shall be allowed under this section to any person by reason of a payment to an account for the benefit of a qualified individual if any amount is paid into an individual retirement account (including a Roth IRA) for the benefit of such individual.

"(5) ROLLOVERS.—No deduction shall be allowed under this section with respect to any rollover contribution.

"(b) TAX TREATMENT OF DISTRIBUTIONS.—

"(1) INCLUSION OF AMOUNTS IN GROSS INCOME.—Except as otherwise provided in this subsection, any amount paid or distributed out of a family development account shall be included in gross income by the payee or distributee, as the case may be.

"(2) EXCLUSION OF QUALIFIED FAMILY DEVELOPMENT DISTRIBUTIONS.—Paragraph (1) shall not apply to any qualified family development distribution.

"(c) QUALIFIED FAMILY DEVELOPMENT DISTRIBUTION.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified family development distribution' means any amount paid or distributed out of a family development account which would otherwise be includible in gross income, to the extent that such payment or distribution is used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder.

"(2) QUALIFIED FAMILY DEVELOPMENT EXPENSES.—The term 'qualified family development expenses' means any of the following:

"(A) Qualified higher education expenses.

"(B) Qualified first-time homebuyer costs.

"(C) Qualified business capitalization costs.

"(D) Qualified medical expenses.

"(E) Qualified rollovers.

"(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified higher education expenses' has the meaning given such term by section 72(t)(7), determined by treating postsecondary vocational educational schools as eligible educational institutions.

"(B) POSTSECONDARY VOCATIONAL EDUCATION SCHOOL.—The term 'postsecondary vocational educational school' means an area vocational education school (as defined in subparagraph (C) or (D) of section 521(4) of the Carl D. Perkins Vocational and Applied Technology Education Act (20 U.S.C. 2471(4))) which is in any State (as defined in section 521(33) of such Act), as such sections are in effect on the date of the enactment of this section.

"(C) 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).

"(4) QUALIFIED FIRST-TIME HOMEBUYER COSTS.—The term 'qualified first-time homebuyer costs' means qualified acquisition costs (as defined in section 72(t)(8) without regard to subparagraph (B) thereof) with respect to a principal residence (within the meaning of section 121) for a qualified first-time homebuyer (as defined in such section).

"(5) QUALIFIED BUSINESS CAPITALIZATION COSTS.—

"(A) IN GENERAL.—The term 'qualified business capitalization costs' means qualified expenditures for the capitalization of a qualified business pursuant to a qualified plan.

"(B) QUALIFIED EXPENDITURES.—The term 'qualified expenditures' means expenditures included in a qualified plan, including capital, plant, equipment, working capital, and inventory expenses.

"(C) QUALIFIED BUSINESS.—The term 'qualified business' means any business that does not contravene any law.

"(D) QUALIFIED PLAN.—The term 'qualified plan' means a business plan which meets such requirements as the Secretary may specify.

"(6) QUALIFIED MEDICAL EXPENSES.—The term 'qualified medical expenses' means any amount paid during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in section 213(d)) of the taxpayer, his spouse, or his dependent (as defined in section 152).

"(7) QUALIFIED ROLLOVERS.—The term 'qualified rollover' means any amount paid from a family development account of a taxpayer into another such account established for the benefit of—

"(A) such taxpayer, or

"(B) any qualified individual who is—

"(i) the spouse of such taxpayer, or

"(ii) any dependent (as defined in section 152) of the taxpayer.

Rules similar to the rules of section 408(d)(3) shall apply for purposes of this paragraph.

"(d) TAX TREATMENT OF ACCOUNTS.—

"(1) IN GENERAL.—Any family development account is exempt from taxation under this subtitle unless such account has ceased to be a family development account by reason of paragraph (2). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc., organizations). Notwithstanding any other provision of this title (including chapters 11 and 12), the basis of any person in such an account is zero.

"(2) LOSS OF EXEMPTION IN CASE OF PROHIBITED TRANSACTIONS.—For purposes of this section, rules similar to the rules of section 408(e) shall apply.

"(3) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (4), (5), and (6) of section 408(d) shall apply for purposes of this section.

"(e) FAMILY DEVELOPMENT ACCOUNT.—For purposes of this title, the term 'family development account' means a trust created or organized in the United States for the exclusive benefit of a qualified individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

"(1) Except in the case of a qualified rollover (as defined in subsection (c)(7))—

"(A) no contribution will be accepted unless it is in cash, and

"(B) contributions will not be accepted for the taxable year in excess of $3,000 (determined without regard to any contribution made under section 1400I (relating to demonstration program to provide matching amounts in renewal communities)).

"(2) The requirements of paragraphs (2) through (6) of section 408(a) are met.

"(f) QUALIFIED INDIVIDUAL.—For purposes of this section, the term 'qualified individual' means, for any taxable year, an individual—

"(1) who is a bona fide resident of a renewal community throughout the taxable year, and

"(2) to whom a credit was allowed under section 32 for the preceding taxable year.

"(g) OTHER DEFINITIONS AND SPECIAL RULES.—

"(1) COMPENSATION.—The term 'compensation' has the meaning given such term by section 219(f)(1).

"(2) MARRIED INDIVIDUALS.—The maximum deduction under subsection (a) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

"(3) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to a family development account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).

"(4) EMPLOYER PAYMENTS; CUSTODIAL ACCOUNTS.—Rules similar to the rules of sections 219(f)(5) and 408(h) shall apply for purposes of this section.

"(5) REPORTS.—The trustee of a family development account shall make such reports regarding such account to the Secretary and to the individual for whom the account is maintained with respect to contributions (and the years to which they relate), distributions, and such other matters as the Secretary may require under regulations. The reports required by this paragraph—

"(A) shall be filed at such time and in such manner as the Secretary prescribes in such regulations, and

"(B) shall be furnished to individuals—

"(i) not later than January 31 of the calendar year following the calendar year to which such reports relate, and "(ii) in such manner as the Secretary prescribes in such regulations.

"(6) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS.—Rules similar to the rules of section 408(m) shall apply for purposes of this section.

"(h) PENALTY FOR DISTRIBUTIONS NOT USED FOR QUALIFIED FAMILY DEVELOPMENT EXPENSES.—

"(1) IN GENERAL.—If any amount is distributed from a family development account and is not used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder, the tax imposed by this chapter for the taxable year of such distribution shall be increased by the sum of—

"(A) 100 percent of the portion of such amount which is includible in gross income and is attributable to amounts contributed under section 1400I (relating to demonstration program to provide matching amounts in renewal communities), and

"(B) 10 percent of the portion of such amount which is includible in gross income and is not described in subparagraph (A).

For purposes of this subsection, distributions which are includable in gross income shall be treated as attributable to amounts contributed under section 1400I to the extent thereof. For purposes of the preceding sentence, all family development accounts of an individual shall be treated as one account.

"(2) EXCEPTION FOR CERTAIN DISTRIBUTIONS.—Paragraph (1) shall not apply to distributions which are—

"(A) made on or after the date on which the account holder attains age 59½,

"(B) made to a beneficiary (or the estate of the account holder) on or after the death of the account holder, or

"(C) attributable to the account holder's being disabled within the meaning of section 72(m)(7).

"(i) TERMINATION.—No deduction shall be allowed under this section for any amount paid to a family development account for any taxable year beginning after December 31, 2006.

"SEC. 1400I. DEMONSTRATION PROGRAM TO PROVIDE MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS IN CERTAIN RENEWAL COMMUNITIES.

"(a) DESIGNATION.—

"(1) DEFINITIONS.—For purposes of this section, the term 'FDA matching demonstration area' means any renewal community—

"(A) which is nominated under this section by each of the local governments and States which nominated such community for designation as a renewal community under section 1400E(a)(1)(A), and

"(B) which the Secretary of Housing and Urban Development designates as an FDA matching demonstration area after consultation with—

"(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration, and

"(ii) in the case of a community on an Indian reservation, the Secretary of the Interior.

"(2) NUMBER OF DESIGNATIONS.—

"(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 5 communities as FDA matching demonstration areas.

"(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under subparagraph (A), at least 2 must be areas described in section 1400E(a)(2)(B).

"(3) LIMITATIONS ON DESIGNATIONS.—

"(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

"(i) the procedures for nominating a renewal community under paragraph (1)(A) (including procedures for coordinating such nomination with the nomination of an area for designation as a renewal community under section 1400E), and

"(ii) the manner in which nominated renewal communities will be evaluated for purposes of this section.

"(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate renewal communities as FDA matching demonstration areas only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

"(4) DESIGNATION BASED ON DEGREE OF POVERTY, ETC.—The rules of section 1400E(a)(3) shall apply for purposes of designations of FDA matching demonstration areas under this section.

"(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—Any designation of a renewal community as an FDA matching demonstration area shall remain in effect during the period beginning on the date of such designation and ending on the date on which such area ceases to be a renewal community.

"(c) MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS.—

"(1) IN GENERAL.—Not less than once each taxable year, the Secretary shall deposit (to the extent provided in appropriation Acts) into a family development account of each qualified individual (as defined in section 1400H(f))—

"(A) who is a resident throughout the taxable year of an FDA matching demonstration area, and

"(B) who requests (in such form and manner as the Secretary prescribes) such deposit for the taxable year,

an amount equal to the sum of the amounts deposited into all of the family development accounts of such individual during such taxable year (determined without regard to any amount contributed under this section).

"(2) LIMITATIONS.—

"(A) ANNUAL LIMIT.—The Secretary shall not deposit more than $1000 under paragraph (1) with respect to any individual for any taxable year.

"(B) AGGREGATE LIMIT.—The Secretary shall not deposit more than $2000 under paragraph (1) with respect to any individual for all taxable years.

"(3) EXCLUSION FROM INCOME.—Except as provided in section 1400H, gross income shall not include any amount deposited into a family development account under paragraph (1).

"(d) NOTICE OF PROGRAM.—The Secretary shall provide appropriate notice to residents of FDA matching demonstration areas of the availability of the benefits under this section.

"(e) TERMINATION.—No amount may be deposited under this section for any taxable year beginning after December 31, 2006.

"SEC. 1400J. DESIGNATION OF EARNED INCOME TAX CREDIT PAYMENTS FOR DEPOSIT TO FAMILY DEVELOPMENT ACCOUNT.

"(a) IN GENERAL.—With respect to the return of any qualified individual (as defined in section 1400H(f)) for the taxable year of the tax imposed by this chapter, such individual may designate that a specified portion (not less than $1) of any overpayment of tax for such taxable year which is attributable to the earned income tax credit shall be deposited by the Secretary into a family development account of such individual. The Secretary shall so deposit such portion designated under this subsection.

"(b) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year—

"(1) at the time of filing the return of the tax imposed by this chapter for such taxable year, or

"(2) at any other time (after the time of filing the return of the tax imposed by this chapter for such taxable year) specified in regulations prescribed by the Secretary.

Such designation shall be made in such manner as the Secretary prescribes by regulations.

"(c) PORTION ATTRIBUTABLE TO EARNED INCOME TAX CREDIT.—For purposes of subsection (a), an overpayment for any taxable year shall be treated as attributable to the earned income tax credit to the extent that such overpayment does not exceed the credit allowed to the taxpayer under section 32 for such taxable year.

"(d) OVERPAYMENTS TREATED AS REFUNDED.—For purposes of this title, any portion of an overpayment of tax designated under subsection (a) shall be treated as being refunded to the taxpayer as of the last date prescribed for filing the return of tax imposed by this chapter (determined without regard to extensions) or, if later, the date the return is filed.

"(e) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2006.

"PART IV—ADDITIONAL INCENTIVES

"Sec. 1400K. Commercial revitalization credit.
"Sec. 1400L. Increase in expensing under section 179.

"SEC. 1400K. COMMERCIAL REVITALIZATION CREDIT.

"(a) GENERAL RULE.—For purposes of section 46, except as provided in subsection (e), the commercial revitalization credit for any taxable year is an amount equal to the applicable percentage of the qualified revitalization expenditures with respect to any qualified revitalization building.

"(b) APPLICABLE PERCENTAGE.—For purposes of this section—

"(1) IN GENERAL.—The term 'applicable percentage' means—

"(A) 20 percent for the taxable year in which a qualified revitalization building is placed in service, or

"(B) at the election of the taxpayer, 5 percent for each taxable year in the credit period.

The election under subparagraph (B), once made, shall be irrevocable.

"(2) CREDIT PERIOD.—

"(A) IN GENERAL.—The term 'credit period' means, with respect to any building, the period of 10 taxable years beginning with the taxable year in which the building is placed in service.

"(B) APPLICABLE RULES.—Rules similar to the rules under paragraphs (2) and (4) of section 42(f) shall apply.

"(c) QUALIFIED REVITALIZATION BUILDINGS AND EXPENDITURES.—For purposes of this section—

"(1) QUALIFIED REVITALIZATION BUILDING.—The term 'qualified revitalization building' means any building (and its structural components) if—

"(A) such building is located in a renewal community and is placed in service after December 31, 1999,

"(B) a commercial revitalization credit amount is allocated to the building under subsection (e), and

"(C) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building.

"(2) QUALIFIED REVITALIZATION EXPENDITURE.—

"(A) IN GENERAL.—The term 'qualified revitalization expenditure' means any amount properly chargeable to capital account—

"(i) for property for which depreciation is allowable under section 168 and which is—

"(I) nonresidential real property, or

"(II) an addition or improvement to property described in subclause (I), and

"(ii) in connection with the construction of any qualified revitalization building which was not previously placed in service or in connection with the substantial rehabilitation (within the meaning of section 47(c)(1)(C)) of a building which was placed in service before the beginning of such rehabilitation.

"(B) DOLLAR LIMITATION.—The aggregate amount which may be treated as qualified revitalization expenditures with respect to any qualified revitalization building for any taxable year shall not exceed the excess of—

"(i) $10,000,000, reduced by

"(ii) any such expenditures with respect to the building taken into account by the taxpayer or any predecessor in determining the amount of the credit under this section for all preceding taxable years.

"(C) CERTAIN EXPENDITURES NOT INCLUDED.—The term 'qualified revitalization expenditure' does not include—

"(i) STRAIGHT LINE DEPRECIATION MUST BE USED.—Any expenditure (other than with respect to land acquisitions) with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1).

"(ii) ACQUISITION COSTS.—The costs of acquiring any building or interest therein and any land in connection with such building to the extent that such costs exceed 30 percent of the qualified revitalization expenditures determined without regard to this clause.

"(iii) OTHER CREDITS.—Any expenditure which the taxpayer may take into account in computing any other credit allowable under this title unless the taxpayer elects to take the expenditure into account only for purposes of this section.

"(d) WHEN EXPENDITURES TAKEN INTO ACCOUNT.—

"(1) IN GENERAL.—Qualified revitalization expenditures with respect to any qualified revitalization building shall be taken into account for the taxable year in which the qualified revitalization building is placed in service. For purposes of the preceding sentence, a substantial rehabilitation of a building shall be treated as a separate building.

"(2) PROGRESS EXPENDITURE PAYMENTS.—Rules similar to the rules of subsections (b)(2) and (d) of section 47 shall apply for purposes of this section.

"(e) LIMITATION ON AGGREGATE CREDITS ALLOWABLE WITH RESPECT TO BUILDINGS LOCATED IN A STATE.—

"(1) IN GENERAL.—The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the commercial revitalization credit amount (in the case of an amount determined under subsection (b)(1)(B), the present value of such amount as determined under the rules of section 42(b)(2)(C)) allocated to such building under this subsection by the commercial revitalization credit agency. Such allocation shall be made at the same time and in the same manner as under paragraphs (1) and (7) of section 42(h).

"(2) COMMERCIAL REVITALIZATION CREDIT AMOUNT FOR AGENCIES.—

"(A) IN GENERAL.—The aggregate commercial revitalization credit amount which a commercial revitalization credit agency may allocate for any calendar year is the amount of the State commercial revitalization credit ceiling determined under this paragraph for such calendar year for such agency.

"(B) STATE COMMERCIAL REVITALIZATION CREDIT CEILING.—The State commercial revitalization credit ceiling applicable to any State—

"(i) for each calendar year after 1999 and before 2007 is $2,000,000 for each renewal community in the State, and

"(ii) zero for each calendar year thereafter.

"(C) COMMERCIAL REVITALIZATION CREDIT AGENCY.—For purposes of this section, the term 'commercial revitalization credit agency' means any agency authorized by a State to carry out this section.

"(f) RESPONSIBILITIES OF COMMERCIAL REVITALIZATION CREDIT AGENCIES.—

"(1) PLANS FOR ALLOCATION.—Notwithstanding any other provision of this section, the commercial revitalization credit amount with respect to any building shall be zero unless—

"(A) such amount was allocated pursuant to a qualified allocation plan of the commercial revitalization credit agency which is approved (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) by the governmental unit of which such agency is a part, and

"(B) such agency notifies the chief executive officer (or its equivalent) of the local jurisdiction within which the building is located of such allocation and provides such individual a reasonable opportunity to comment on the allocation.

"(2) QUALIFIED ALLOCATION PLAN.—For purposes of this subsection, the term 'qualified allocation plan' means any plan—

"(A) which sets forth selection criteria to be used to determine priorities of the commercial revitalization credit agency which are appropriate to local conditions,

"(B) which considers—

"(i) the degree to which a project contributes to the implementation of a strategic plan that is devised for a renewal community through a citizen participation process,

"(ii) the amount of any increase in permanent, full-time employment by reason of any project, and

"(iii) the active involvement of residents and nonprofit groups within the renewal community, and

"(C) which provides a procedure that the agency (or its agent) will follow in monitoring compliance with this section.

"(g) TERMINATION.—This section shall not apply to any building placed in service after December 31, 2006.

"SEC. 1400L. INCREASE IN EXPENSING UNDER SECTION 179.

"(a) GENERAL RULE.—In the case of a renewal community business (as defined in section 1400G), for purposes of section 179—

"(1) the limitation under section 179(b)(1) shall be increased by the lesser of—

"(A) $35,000, or

"(B) the cost of section 179 property which is qualified renewal property placed in service during the taxable year, and

"(2) the amount taken into account under section 179(b)(2) with respect to any section 179 property which is qualified renewal property shall be 50 percent of the cost thereof.

"(b) RECAPTURE.—Rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified renewal property which ceases to be used in a renewal community by a renewal community business.

"(c) QUALIFIED RENEWAL PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified renewal property' means any property to which section 168 applies (or would apply but for section 179) if—

"(A) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 1999, and before January 1, 2007, and

"(B) such property would be qualified zone property (as defined in section 1397C) if references to renewal communities were substituted for references to empowerment zones in section 1397C.

"(2) CERTAIN RULES TO APPLY.—The rules of subsections (a)(2) and (b) of section 1397C shall apply for purposes of this section."

SEC. 603. EXTENSION OF EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS TO RENEWAL COMMUNITIES.

(a) EXTENSION.—Paragraph (2) of section 198(c) (defining targeted area) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) RENEWAL COMMUNITIES INCLUDED.—Except as provided in subparagraph (B), such term shall include a renewal community (as defined in section 1400E)."

(b) EXTENSION OF TERMINATION DATE FOR RENEWAL COMMUNITIES.—Subsection (h) of section 198 is amended by inserting before the period "(December 31, 2006, in the case of a renewal community, as defined in section 1400E)."

SEC. 604. EXTENSION OF WORK OPPORTUNITY TAX CREDIT FOR RENEWAL COMMUNITIES.

(a) EXTENSION.—Subsection (c) of section 51 (relating to termination) is amended by adding at the end the following new paragraph:

"(5) EXTENSION OF CREDIT FOR RENEWAL COMMUNITIES.—

"(A) IN GENERAL.—In the case of an individual who begins work for the employer after the date contained in paragraph (4)(B), for purposes of section 38—

"(i) in lieu of applying subsection (a), the amount of the work opportunity credit determined under this section for the taxable year shall be equal to—

"(I) 15 percent of the qualified first-year wages for such year, and

"(II) 30 percent of the qualified second-year wages for such year,

"(ii) subsection (b)(3) shall be applied by substituting '$10,000' for '$6,000',

"(iii) paragraph (4)(B) shall be applied by substituting for the date contained therein the last day for which the designation under section 1400E of the renewal community referred to in subparagraph (B)(i) is in effect, and

"(iv) rules similar to the rules of section 51A(b)(5)(C) shall apply.

"(B) QUALIFIED FIRST- AND SECOND-YEAR WAGES.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified wages' means, with respect to each 1-year period referred to in clause (ii) or (iii), as the case may be, the wages paid or incurred by the employer during the taxable year to any individual but only if—

"(I) the employer is engaged in a trade or business in a renewal community throughout such 1-year period,

"(II) the principal place of abode of such individual is in such renewal community throughout such 1-year period, and

"(III) substantially all of the services which such individual performs for the employer during such 1-year period are performed in such renewal community.

"(ii) 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.

"(iii) 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 clause (ii)."

(b) CONGRUENT TREATMENT OF RENEWAL COMMUNITIES AND ENTERPRISE ZONES FOR PURPOSES OF YOUTH RESIDENCE REQUIREMENTS.—

(1) HIGH-RISK YOUTH.—Subparagraphs (A)(ii) and (B) of section 51(d)(5) are each amended by striking "empowerment zone or enterprise community" and inserting "empowerment zone, enterprise community, or renewal community".

(2) QUALIFIED SUMMER YOUTH EMPLOYEE.—Clause (iv) of section 51(d)(7)(A) is amended by striking "empowerment zone or enterprise community" and inserting "empowerment zone, enterprise community, or renewal community".

(3) HEADINGS.—Paragraphs (5)(B) and (7)(C) of section 51(d) are each amended by inserting "OR COMMUNITY" in the heading after "ZONE".

SEC. 605. CONFORMING AND CLERICAL AMENDMENTS.

(a) DEDUCTION FOR CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS ALLOWABLE WHETHER OR NOT TAXPAYER ITEMIZES.—Subsection (a) of section 62 (relating to adjusted gross income defined) is amended by inserting after paragraph (17) the following new paragraph:

"(18) FAMILY DEVELOPMENT ACCOUNTS.—The deduction allowed by section 1400H(a)(1)(A)."

(b) TAX ON EXCESS CONTRIBUTIONS.—

(1) TAX IMPOSED.—Subsection (a) of section 4973 is amended by striking "or" at the end of paragraph (3), adding "or" at the end of paragraph (4), and inserting after paragraph (4) the following new paragraph:

"(5) a family development account (within the meaning of section 1400H(e)),".

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

"(g) FAMILY DEVELOPMENT ACCOUNTS.—For purposes of this section, in the case of a family development account, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the account (other than a qualified rollover, as defined in section 1400H(c)(7), or a contribution under section 1400I), over

"(B) the amount allowable as a deduction under section 1400H for such contributions, and

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

"(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 1400H(b)(1),

"(B) the distributions out of the account for the taxable year to which rules similar to the rules of section 408(d)(5) apply by reason of section 1400H(d)(3), and

"(C) the excess (if any) of the maximum amount allowable as a deduction under section 1400H for the taxable year over the amount contributed to the account for the taxable year (other than a contribution under section 1400I).

For purposes of this subsection, any contribution which is distributed from the family development account in a distribution to which rules similar to the rules of section 408(d)(4) apply by reason of section 1400H(d)(3) shall be treated as an amount not contributed."

(c) TAX ON PROHIBITED TRANSACTIONS.—Section 4975 is amended—

(1) by adding at the end of subsection (c) the following new paragraph:

"(6) SPECIAL RULE FOR FAMILY DEVELOPMENT ACCOUNTS.—An individual for whose benefit a family development 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, with respect to such transaction, the account ceases to be a family development account by reason of the application of section 1400H(d)(2) to such account.", and

(2) in subsection (e)(1), by striking "or" at the end of subparagraph (E), by redesignating subparagraph (F) as subparagraph (G), and by inserting after subparagraph (E) the following new subparagraph:

"(F) a family development account described in section 1400H(e), or".

(d) INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY PLANS.—Subsection (c) of section 6047 is amended—

(1) by inserting "or section 1400H" after "section 219", and

(2) by inserting ", of any family development account described in section 1400H(e),", after "section 408(a)".

(e) INSPECTION OF APPLICATIONS FOR TAX EXEMPTION.—Clause (i) of section 6104(a)(1)(B) is amended by inserting "a family development account described in section 1400H(e)," after "section 408(a),".

(f) FAILURE TO PROVIDE REPORTS ON FAMILY DEVELOPMENT ACCOUNTS.—Paragraph (2) of section 6693(a) is amended by striking "and" at the end of subparagraph (C), by striking the period and inserting ", and" at the end of subparagraph (D), and by adding at the end the following new subparagraph:

"(E) section 1400H(g)(6) (relating to family development accounts)."

(g) CONFORMING AMENDMENTS REGARDING COMMERCIAL REVITALIZATION CREDIT.—

(1) Section 46 (relating to investment credit) 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 adding at the end the following new paragraph:

"(4) the commercial revitalization credit provided under section 1400K."

(2) Section 39(d) is amended by adding at the end the following new paragraph:

"(9) NO CARRYBACK OF SECTION 1400K CREDIT BEFORE DATE OF ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to any commercial revitalization credit determined under section 1400K may be carried back to a taxable year ending before the date of the enactment of section 1400K."

(3) Subparagraph (B) of section 48(a)(2) is amended by inserting "or commercial revitalization" after "rehabilitation" each place it appears in the text and heading.

(4) Subparagraph (C) of section 49(a)(1) is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding at the end the following new clause:

"(iv) the portion of the basis of any qualified revitalization building attributable to qualified revitalization expenditures."

(5) Paragraph (2) of section 50(a) is amended by inserting "or 1400K(d)(2)" after "section 47(d)" each place it appears.

(6) Subparagraph (A) of section 50(a)(2) is amended by inserting "or qualified revitalization building (respectively)" after "qualified rehabilitated building".

(7) Subparagraph (B) of section 50(a)(2) is amended by adding at the end the following new sentence: "A similar rule shall apply for purposes of section 1400K."

(8) Paragraph (2) of section 50(b) 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 adding at the end the following new subparagraph:

"(E) a qualified revitalization building (as defined in section 1400K) to the extent of the portion of the basis which is attributable to qualified revitalization expenditures (as defined in section 1400K)."

(9) The last sentence of section 50(b)(3) is amended to read as follows: "If any qualified rehabilitated building or qualified revitalization building is used by the tax-exempt organization pursuant to a lease, this paragraph shall not apply for purposes of determining the amount of the rehabilitation credit or the commercial revitalization credit."

(10) Subparagraph (C) of section 50(b)(4) is amended—

(A) by inserting "or commercial revitalization" after "rehabilitated" in the text and heading, and

(B) by inserting "or commercial revitalization" after "rehabilitation".

(11) Subparagraph (C) of section 469(i)(3) is amended—

(A) by inserting "or section 1400K" after "section 42"; and

(B) by striking "CREDIT" in the heading and inserting "AND COMMERCIAL REVITALIZATION CREDITS".

(h) CLERICAL AMENDMENTS.—The table of subchapters for chapter 1 is amended by adding at the end the following new item:

"Subchapter X. Renewal Communities."

SEC. 606. EVALUATION AND REPORTING REQUIREMENTS.

Not later than the close of the fourth calendar year after the year in which the Secretary of Housing and Urban Development first designates an area as a renewal community under section 1400E of the Internal Revenue Code of 1986, and at the close of each fourth calendar year thereafter, such Secretary shall prepare and submit to the Congress a report on the effects of such designations in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

I. SUMMARY AND BACKGROUND

A. PURPOSE AND SUMMARY

PURPOSE

The bill, H.R. 4579 ("Taxpayer Relief Act of 1998") is intended to provide needed tax relief for the nation's families, farmers and small businesses, provide education and community renewal tax incentives, extend certain expired and expiring tax and trade provisions, increase the earnings limit for Social Security recipients, modify the treatment of certain deductible liquidating distributions of regulated investment companies ("RICs") and real estate investment trusts ("REITs") to close an existing tax loophole, and provide necessary technical corrections to recent tax legislation.

SUMMARY OF THE BILL

Family tax relief provisions

Marriage penalty tax relief.—The bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for a single return in each taxable year beginning after December 31, 1998. Also, the basic standard deduction for a married taxpayer filing separately will be increased so that it will equal the basic standard deduction for singles. Further, the bill increases the additional standard deduction for married individuals who are elderly or blind to the same amount allowed for singles and heads of households. These amounts will be indexed for inflation.

Partial exclusion for interest and dividends.—The bill provides an exclusion from income for individuals for up to $200 ($400 for married couples filing jointly) of combined interest and dividends received in a taxable year. The provision is effective for taxable years beginning after December 31, 1998.

Treatment of personal credits under the individual minimum tax.—The bill will allow nonrefundable personal tax credits to offset both the individual's regular income tax liability and the minimum tax liability. The bill also repeals the rule that reduces the additional child credit and the earned income credit by the amount of the minimum tax liability. The provision is effective for taxable years beginning after December 31, 1997.

Exclusion of gain on the sale of a principal residence by a member of the uniformed services or the Foreign Service of the United States.—The bill suspends the test period for ownership and use during certain absences due to service in the uniformed services or the Foreign Service of the United States. Specifically, the 5-year period ending on the date of the sale or exchange of a principal residence will not include any periods during which the taxpayer or the taxpayer's spouse was on qualified official extended duty as a member of the uniformed services or the Foreign Service of the United States and serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as 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. The provision is effective for sales or exchanges of principal residences after the date of enactment.

Education and infrastructure provisions

Permit private higher education institutions to establish qualified prepaid tuition programs.—The definition of a “qualified tuition program” is expanded to include programs established and maintained by one or more private educational institutions. The provision is effective for taxable years beginning after December 31, 1998.

Expand exception from arbitrage rebate for tax-exempt bonds issued to finance public school construction.—The bill liberalizes the permitted expenditure period of the present-law construction bond exception in the case of bonds issued to finance the construction of public schools. Amounts spent for the acquisition and improvement of land that is functionally related and subordinate to a school, the construction of which is financed with proceeds of the bond issue, will be treated as spent for construction. Under the provision, no rebate will be required on the construction proceeds of these public school construction bonds if the proceeds (less presently allowed retainage) were spent within four years after the bonds are issued, and the following intermediate spending targets are satisfied: (1) 10 percent or more of the construction proceeds is spent within one year after the bonds are issued; (2) 30 percent or more of the construction proceeds is spent within two years after the bonds are issued; and (3) 50 percent or more of the construction proceeds is spent within three years after the bonds are issued. The provision applies to bonds issued after December 31, 1998.

Increase State volume limits on private activity tax-exempt bonds.—The bill increases the annual State private activity bond volume limits to $75 (from $50) per resident of each State, or to $225 million (from $150 million) if greater. The provision is effective beginning in calendar year 1999.

Estate tax, small business and farmer tax relief provisions

Acceleration of increased exemption from estate and gift tax.—The bill accelerates the scheduled increases in the applicable exemption amount so that the exemption equivalent will be $1,000,000 for decedents dying and gifts made after December 31, 1998.

Increase deduction for health insurance expenses of self-employed individuals.—The bill increases the deduction for health insurance of self-employed individuals to 100 percent for taxable years beginning in 1999 and thereafter.

Accelerate increase in expensing for small business.—The bill increases the maximum dollar amount that may be deducted under Code section 179 to $25,000 for taxable years beginning in 1999 and thereafter, without the present-law phase-in rule.

Permanent extension of income averaging for farmers.—The bill makes permanent income averaging for farmers.

Extend the net operating loss (NOL) carryback period for farmers.—The bill allows NOLs attributable to a farming business to be carried back five years, whether or not incurred in a Presidentially declared disaster area. The carryforward period will remain at 20 years. A taxpayer may elect to not apply the five-year carryback period. The NOL rule attributable to a farming business will be coordinated with the other NOL rules. The provision is effective for NOLs taxable years beginning after December 31, 1997.

Production flexibility contract payments.—Under the bill, the option added by the Emergency Farm Financial Relief Act of 1998 to accelerate certain production flexibility payments is disregarded in determining the taxable year in which such payments must be included in income. The provision is effective for Federal Agriculture Improvement and Reform Act of 1996 payments for fiscal year 1999.

Designation of 20 "renewal communities."—The bill authorizes the designation of 20 "renewal communities" within which special tax incentives will be available. The tax benefits available in "renewal communities" generally will be effective for the seven-year period beginning January 1, 2000, and ending December 31, 2006.

Extension of expiring provisions

Extension of research tax credit.—The research tax credit is extended for the period July 1, 1998, through February 29, 2000. In addition, the credit rate applicable under the alternative incremental credit will be increased by one percentage point per step, that is from 1.65 percent to 2.65 percent when a taxpayer's current-year research expenses exceed a base amount of 1 percent but do not exceed a base amount of 1.5 percent; from 2.2 percent to 3.2 percent when a taxpayer's current-year research expenses exceed a base amount of 1.5 percent but do not exceed a base amount of 2 percent; and from 2.75 percent to 3.75 percent when a taxpayer's current-year research expenses exceed a base amount of 2 percent.

Taxpayers will be permitted to elect the alternative incremental research credit regime under Code 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. Extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1998, through February 29, 2000. The increase in the credit rate under the alternative incremental credit is effective for taxable years beginning after June 30, 1998.

Extension of work opportunity tax credit.—The bill extends the work opportunity tax credit through February 29, 2000. The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1998, and before March 1, 2000.

Extension of the welfare-to-work tax credit.—The bill extends through February 29, 2000, the welfare-to-work tax credit for wages paid or incurred to a qualified individual. The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after May 1, 1999, and before March 1, 2000.

Extend the deduction provided for contributions of appreciated stock to private foundations.—The bill extends permanently the special rule contained in Code section 170(e)(5). The provision is effective for contributions of qualified appreciated stock to private foundations made on or after July 1, 1998.

Public inspection of private foundation annual returns.—Under the bill, private foundations will be subject to the public inspection requirements that currently apply to all other tax-exempt organizations that file annual information returns. Private foundations will no longer be subject to the publication requirements of Code section 6104(d). The public inspection requirements apply to requests made no earlier than 60 days after the Treasury Department publishes regulations defining when documents are widely available or where a request is a part of a harassment campaign, but in any event not before December 31, 1998.

Exceptions under subpart F for certain active financing income.—The bill modifies the present-law temporary exceptions from subpart F for income that is derived in the active conduct of a banking, financing, insurance, or similar business. These exceptions (as modified) are applicable only for taxable years beginning in 1999.

With respect to income derived in the active conduct of a banking, financing, or similar business, the provision differs from the present-law temporary exceptions in the following significant respects. First, the provision requires a Controlled Foreign Corporation ("CFC") to conduct substantial activity with respect to its business in order to qualify for the exceptions. Second, the provision adds certain nexus requirements which would require that income which is derived by a CFC or a Qualified Business Unit ("QBU") from transactions with customers would be eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Third, the provision modifies the tests for determining whether a CFC is predominantly engaged in the active conduct of a banking, financing, or similar business, including modifications for income derived from a lending or finance business. Fourth, the provision extends the exceptions to income derived from certain cross-border transactions, provided that certain requirements are met. Fifth, the determination of where a customer is treated as located will be made under rules prescribed by the Secretary of the Treasury. Finally, the look-through rule that was included in the present-law provision for purposes of determining the income eligible for the exceptions will be eliminated.

In the case of insurance, the provision differs from present law in the following significant respects. In addition to the exception for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization that is provided under present law, the provision will provide additional exceptions. First, the provision provides temporary exceptions from insurance income and from foreign personal holding company income for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, the provision adds additional temporary exceptions from insurance income and from foreign personal holding company income for certain income of certain CFCs or branches with respect to risks located in any country other than the United States, provided that requirements for these exceptions are met. The provision applies only to taxable years of foreign corporations beginning in 1999, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

Extension of the generalized system of preferences ("GSP").—The bill reauthorizes the GSP trade program through February 29, 2000. Refunds will be authorized, upon request of the importer, for duties paid between July 1, 1998, and the date of enactment of the bill. The provision is effective for duties paid on or after July 1, 1998, and before March 1, 2000.

Revenue offset provision

Treatment of certain deductible liquidating distributions of regulated investment companies ("RICs") and real estate investment trusts ("REITs").—Under the bill, any amount which a liquidating RIC or REIT may take as a deduction for dividends paid with respect to an otherwise tax-free liquidating distribution to an 80-percent corporate owner will be includible in the income of the recipient corporation. The includible amount will be treated as a dividend received from the RIC or REIT. The liquidating corporation will be able to designate the amount treated as a dividend, as a capital gain dividend or, in the case of a RIC, a dividend eligible for the 70-percent dividends received deduction, to the extent provided by the RIC or REIT provisions of the Code.

The bill does not otherwise change the tax treatment of the distribution to the parent corporation or to the RIC or REIT. Thus, for example, the liquidating corporation would not recognize gain (if any) on the liquidating distribution and the recipient corporation will hold the assets at a carryover basis. The bill is effective for distributions on or after May 22, 1998, regardless of when the plan of liquidation was adopted. No inference is intended regarding the treatment of such transactions under present law.

Tax technical corrections provisions

The bill makes necessary technical corrections to recent tax legislation, including the Internal Revenue Service Restructuring and Reform Act of 1998 ("1998 Act"), the Taxpayer Relief Act of 1997 ("1997 Act"), and other tax legislation.

Social Security provisions

Increases in the Social Security earnings limit for individuals who have attained retirement age.—The bill increases the Social Security earnings limit for those between full retirement age (currently age 65) and age 70 in calendar years 1999–2008, as follows:

Year	Earnings limit
1999	$17,000
2000	18,500
2001	26,000
2002	30,000
2003	31,300
2004	34,000
2005	35,400
2006	36,800
2007	38,350
2008	39,750

Senior citizens between full retirement age (currently age 65) and 70 who earn over the given earnings limit for the year would continue to lose $1 in benefits for every $3 earned over the limit. After 2008, the annual exempt amounts will be indexed to growth in average wages. The provision is effective for the taxable years ending after 1998.

Recomputations of benefits after normal retirement age.—Under the bill, recomputation of benefits resulting from earnings in the year after a worker reaches normal retirement age (currently age 65) and later will be reflected in the recipient's benefit check, effective with the January of the second year after the year of the earnings, one year later than under current law. An exception is provided for recipients who have one or more "zero" years of earnings in their wage averaging computation. Earnings continue to be credited as under present law for purposes of establishing entitlement. The provision is effective for earnings beginning in 1998.

B. Background and Need for Legislation

As the Congress has moved to balance the Federal budget, the Congressional Budget Office ("CBO") has recently estimated that the economy is projected to produce a $1.6 trillion budget surplus for fiscal years 1998–2008. The Committee has determined that a modest portion (about 10 percent) should be returned to the taxpayers to reduce their Federal tax burden, which is currently (CBO's fiscal year 1998 estimate) at a record peacetime 20.5 percent of Gross Domestic Product. The goal of the Committee is to provide needed tax relief while preserving 90 percent of the projected Federal budget surplus until Social Security is reformed.

The bill will provide a net revenue reduction of $80,074 million in fiscal years 1999–2003. (See Part IV.A. of this report for detailed estimates of the budget effects of the bill.) In a separately reported bill (H.R. 4578), the Committee approved the creation of a new Treasury Account, the "Protect Social Security Account," into which will be deposited 90 percent of the estimated unified budget surplus. Such payments are to reserve 90 percent of any budget surplus until a long-term solution for the Social Security system is enacted. The tax reduction bill (H.R. 4579) will only involve about 10 percent of the projected budget surplus and will allow families, farmers and small businesses to retain a portion of the overall Federal budget surplus rather than sending such projected surplus revenues to the Federal Government. This will prevent the bill's tax reduction amounts from being spent by the Federal Government.

C. Legislative History

The bill, H.R. 4579, was introduced by Chairman Archer on September 16, 1998. The Committee marked up the bill on September 17, 1998, and approved the bill with the Chairman's amendment in the nature of a substitute by a roll call vote of 23 yeas and 15 nays.

II. EXPLANATION OF THE BILL

TITLE I. INDIVIDUAL AND FAMILY TAX RELIEF PROVISIONS

A. MARRIAGE PENALTY TAX RELIEF (SEC. 101 OF THE BILL AND SEC. 63 OF THE CODE)

PRESENT LAW

Marriage penalty

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

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

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

Under present law, the size of the standard deduction and the tax bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and tax bracket breakpoints for single filers are roughly 60 percent of those for joint filers.[1] With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals.

Basic standard deduction

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable), which is subtracted (along with the deduction for personal exemptions) from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is indexed for inflation. For 1999, the size of the basic standard deduction is projected to be as follows:[2]

Filing status	*Basic standard deduction*
Married, joint return	$7,200
Head of household return	6,250
Single return	4,300
Married, separate return	3,600

[1] This is not true for the 39.6-percent rate. The beginning point of this rate bracket is the same for all taxpayers regardless of filing status.

[2] Joint Committee on Taxation staff projections.

For 1999, the basic standard deduction for joint returns is projected to be 1.675 times the basic standard deduction for single returns.

Additional standard deductions

An additional standard deduction is allowed for a taxpayer who is either elderly (age 65 or over) or blind. Two additional standard deductions are allowed for a taxpayer who is elderly (age 65 or over) and blind. In the case of a joint return, these rules apply to both the husband and the wife. For example, if both taxpayers filing a joint return are both elderly and blind then they are entitled to four additional standard deductions. For 1999, the amount of each additional standard deduction is projected to be $800 for married individuals and $1,050 for singles and heads of households. [3] These amounts are indexed for inflation.

REASONS FOR CHANGE

The Committee is concerned about the inequity of the marriage penalty created by the present-law income tax. One primary concern of the Committee is that the marriage penalty may act as a potential disincentive to work for certain married couples. Also, the Committee believes that relief from the marriage penalty is needed because the marriage penalty may undermine respect for the family and may discourage family formation. Any attempt to address the marriage penalty involves the balancing of several competing principles, including equal tax treatment of married couples with equal incomes and the determination of equitable relative tax burdens of single individuals and married couples with equal incomes. The Committee believes that an increase in the standard deduction for married couples filing a joint return is a responsible first step towards removing the marriage penalty. It provides tax relief in 1999 to approximately 48 million married individuals, including more than 10 million senior citizens. Further, approximately six million individuals who currently itemize their deductions would realize the simplification benefits of using the basic standard deduction. Finally, the modification to the additional standard deduction amounts eliminates the disparate tax treatment under present law for the aged and blind based solely upon filing status.

EXPLANATION OF PROVISION

The bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for a single return in each taxable year beginning after December 31, 1998. For example, the basic standard deduction for a married couple filing a joint return is increased from a projected $7,200 to $8,600 in 1999. The basic standard deduction for a married taxpayer filing separately is increased so that it equals the basic standard deduction for singles and equals one-half of the basic standard deduction for a married couple filing jointly for each taxable year beginning after December 31, 1998 (e.g., $4,300 in 1999). The basic standard deduction for a head of household is unchanged.

[3] Joint Committee on Taxation staff projections.

Also, the bill increases the additional standard deduction for a married individual who is elderly or blind from $800 to $1,050 (the same amount allowed for singles and heads of households). This amount is indexed for inflation. The other rules relating to the additional standard deduction are not changed.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

B. Partial Exclusion for Interest and Dividends (sec. 102 of the bill and new sec. 116 of the Code)

PRESENT LAW

The Code states that, except as otherwise provided, "gross income means all income from whatever source derived" (sec. 61). Because there is no exclusion for interest and dividends, interest and dividends received by individuals are includible in income and subject to tax.

REASONS FOR CHANGE

The Committee believes that an exclusion from income for interest and dividends will provide an incentive for savings and will simplify the tax returns of a number of individuals. Approximately 68 million tax returns for 1999 will reflect tax savings as a result of this provision; out of that number, approximately 32 million tax returns will reflect a total exclusion from tax for all interest and dividends received. [4]

EXPLANATION OF PROVISION

The bill provides an exclusion from income for individuals for up to $200 ($400 for married couples filing jointly) of combined interest and dividends (other than capital gain dividends from RICs and REITs, dividends from tax-exempt corporations, and dividends received from an employee stock ownership plan) received in a taxable year. [5]

The Committee encourages the IRS to implement this provision so as to simplify the process of completing tax forms to the greatest extent practicable. For example, the Committee encourages the IRS to consider raising the administratively-established dollar thresholds for completing Schedule B or for being able to use the Form 1040EZ.

In determining eligibility for the earned income credit ("EIC'), any interest or dividends excluded from gross income under this provision is excluded for purposes of the EIC disqualified income test.

The fact that dividends may be excluded from income pursuant to this provision does not affect the computation of the foreign tax credit.

[4] Joint Committee on Taxation staff projections.

[5] From 1954 until 1986, the Code (sec. 116) contained an exclusion from income (in varying amounts) for dividends. For 1981 only, that provision was also extended to interest; this provision is generally parallel to that provision. The exclusion for dividends was repealed by the Tax Reform Act of 1986.

The exclusion under this provision is in addition to, and is to be applied after, the exclusion for educational savings bond interest (sec. 135). In applying those provisions of the Code (such as secs. 86, 219, 221, and 469) that determine modified adjusted gross income without regard to section 135, it is intended that the exclusion under this provision be computed without regard to the savings bond interest exclusion. Thus, for example, if an individual has $100 of interest from a qualified U.S. savings bond, and $150 of other interest, in determining modified adjusted gross income for purposes of section 219(g)(3), the individual will treat $200 as excluded from income under section 116, notwithstanding that the amount of the actual exclusion under section 116 (after applying section 135) is less than $200.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

C. Treatment of Personal Credits Under the Individual Minimum Tax (sec. 103 of the bill and sec. 26 of the Code)

PRESENT LAW

Present law imposes a minimum tax ("AMT") on an individual to the extent the individual's tentative minimum tax exceeds his or her regular income tax liability. The tentative minimum tax is computed at rates of (1) 26 percent on the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent on the remaining AMTI. The maximum tax rates on net capital gain are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) $45,000 in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 in the case of other unmarried individuals; and (3) $22,500 in the case of married individuals filing a separate return, estates and trusts. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) $150,000 in the case of married individuals filing a joint return and surviving spouses, (2) $112,500 in the case of other unmarried individuals, and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child tax credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, and the D.C. homebuyer's credit). Generally, these credits are reduced or eliminated for individuals with adjusted gross incomes above certain specified amounts, and may not exceed the amount by which the individual's regular income tax liability exceeds the individual's tentative minimum tax (determined without regard to the AMT foreign tax credit). For families with three or more qualifying children, an additional child credit is provided which may offset the liability for social security taxes to the extent that tax liability exceeds the amount of the earned income credit. The additional child credit is reduced by the amount of the individual's minimum tax liability. A similar rule applies to the earned income credit.

REASONS FOR CHANGE

The individual minimum tax was enacted by Congress to ensure that no taxpayer with substantial economic income can avoid significant tax liability by using exclusions, deductions, and credits.[6] The Committee believes that allowing middle-income families to use the nonrefundable personal tax credits to offset the minimum tax will not undermine the policy of the minimum tax, and will promote the important social policies underlying each of the credits.

Allowing these credits to offset the minimum tax will result in significant simplification. Substantially fewer taxpayers will need to complete the minimum tax form (Form 6251), and worksheets accompanying the credits will be greatly simplified.

EXPLANATION OF PROVISION

The provision allows the nonrefundable personal tax credits to offset both an individual's regular income tax liability and the AMT.

The provision also repeals the rule that reduces the additional child credit and the earned income credit by the amount of an individual's AMT.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1997.

For taxable years beginning in 1998, the nonrefundable personal credits may offset an individual's regular tax in full, but not an individual's AMT.

D. Increase Deduction for Health Insurance Expenses of Self-Employed Individuals (sec. 104 of the bill and sec. 162(l) of the Code)

PRESENT LAW

Under present law, self-employed individuals are entitled to deduct a portion of the amount paid for health insurance, including (within certain limits) long-term care insurance, for the self-employed individual and the individual's spouse and dependents. 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.[7] The deduction is available in the case of self insurance as well as commercial insurance. The self-insured plan must in fact be insurance (e.g., there

[6] See H. Rept 99–426, p. 305–6 and S. Rept. 99–313, p. 518.
[7] This rule is applied separately to long-term care insurance and other health insurance.

must be appropriate risk shifting) and not merely a reimbursement arrangement.

The portion of health insurance expenses of self-employed individuals that is deductible is 45 percent for taxable years beginning in 1998 and 1999, 50 percent for taxable years beginning in 2000 and 2001, 60 percent for taxable years beginning in 2002, 80 percent for taxable years beginning in 2003, 2004, and 2005, 90 percent for taxable years beginning in 2006, and 100 percent for taxable years beginning in 2007 and thereafter.

Under present law, employees can exclude from income 100 percent of employer-provided health insurance.

REASONS FOR CHANGE

The Committee believes it appropriate to increase the deduction for health insurance expenses of self-employed individuals in order to reduce the disparity of treatment between such expenses and employer-provided health insurance and to help make health insurance more affordable for self-employed individuals.

EXPLANATION OF PROVISION

The provision increases the deduction for health insurance of self-employed individuals to 100 percent for taxable years beginning in 1999 and thereafter.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

E. Exclusion of Gain on the Sale of a Principal Residence by a Member of the Uniformed Service or the Foreign Service of the United States (sec. 105 of the bill and sec. 121 of the Code)

PRESENT LAW

Under present law, an individual taxpayer may 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. To be eligible for the exclusion, the taxpayer must have owned and used the residence 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, to the extent provided under regulations, unforeseen circumstances is able to exclude an amount equal to the fraction of the $250,000 ($500,000 if married filing a joint return) which is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to members of the uniformed services or the Foreign Service of the United States.

REASONS FOR CHANGE

The Committee believes that members of the uniformed services and the Foreign Service of the United States who would otherwise qualify for the exclusion of the gain on the sale of a principal residence will not be deprived the exclusion because of service to their country.

EXPLANATION OF PROVISION

Under the bill, the 5-year test period for ownership and use is suspended during certain absences due to service in the uniformed services or the Foreign Service of the United States. The uniform services include: (1) the armed forces (the Army, Navy, Air Force, Marine Corp, and Coast Guard); (2) the commissioned corps of the National Oceanic and Atmospheric Administration; and (3) the commissioned corps of the Public Health Service. Specifically, the five-year period ending on the date of the sale or exchange of a principal residence does not include any periods during which the taxpayer or the taxpayer's spouse is on qualified official extended duty as a member of the uniformed services or the Foreign Service of the United States. Qualified official extended duty is any period of extended duty by a member of the uniformed services or the Foreign Service of the United States while serving at a place of duty at least 50 miles away from the taxpayer's principal residence or under orders compelling residence in Government furnished quarters. Extended duty is defined as 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.

EFFECTIVE DATE

The provision is effective for sales or exchanges of principal residences after the date of enactment.

F. ACCELERATION OF INCREASED EXEMPTION FROM ESTATE AND GIFT TAX (SEC. 106 OF THE BILL AND SEC. 2010 OF THE CODE)

PRESENT LAW

Increase in exemption from estate and gift tax.—Exemptions from the Federal estate and gift tax are provided by allowing reduction of the estate or gift tax by a credit, called the unified credit. The 1997 Act increased the present-law unified credit beginning in 1998, from an effective exemption (called the "applicable exemption amount") of $600,000 in 1997 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 applicable exemption amount is not indexed for inflation.

Deduction for interests in certain family-owned business.—In addition, the 1997 Act provided a limited deduction for Federal estate tax purposes for certain family-owned business interests. The deduction for family-owned business interests may be taken only to the extent that the deduction for family-owned business interests, plus the applicable exemption amount, does not exceed $1.3 million.

REASONS FOR CHANGE

The Committee believes that increasing the amount of the estate and gift tax unified credit encourages saving, promotes capital formation and entrepreneurial activity, and helps preserve existing family-owned farms and businesses. The Committee believes that acceleration of the scheduled increases in the unified credit will accelerate these benefits and provide more uniform levels of taxation among decedents whenever they die.

EXPLANATION OF PROVISION

The bill accelerates the scheduled increase in the applicable exemption amount to $1,000,000 for decedents dying and gifts made after 1998. The bill retains the $1.3 million limitation on the combined applicable exclusion amount and the deduction for family-held business interests and, thus, the maximum deduction for family-held business interests under the bill is $300,000.

EFFECTIVE DATE

The provision is effective for decedents dying, and gifts made, after December 31, 1998.

G. EDUCATION PROVISIONS

1. Permit private higher education institutions to establish qualified prepaid tuition programs (sec. 111 of the bill and sec. 529 of the Code)

PRESENT LAW

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), as well as certain 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.[8]

REASONS FOR CHANGE

To preserve a level playing field, the Committee believes that private institutions of higher education should be allowed to establish and maintain qualified tuition programs on the same basis that States may do so under present law.

EXPLANATION OF PROVISION

Under the bill, the definition of a "qualified tuition program" is expanded to include any program established and maintained by one or more eligible educational institutions (which may be private institutions that are not State-owned) that satisfies the requirements under present-law section 529 (other than the State-ownership rule).

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

2. Modification of arbitrage rebate rules applicable to public school construction bonds (sec. 112 of the bill and sec. 148 of the Code)

PRESENT LAW

Interest on bonds issued by States and local governments is excluded from income if the proceeds of the bonds are used to finance activities conducted and paid for by the governmental units (Code sec. 103). Interest on bonds issued by these governmental units to finance activities carried out and paid for by private persons ("private activity bonds") is taxable unless the activities are specified in the Internal Revenue Code. Private activity bonds on which interest may be tax-exempt include bonds for privately operated transportation facilities (airports, docks and wharves, mass transit, and high speed rail facilities), privately owned and/or provided municipal services (water, sewer, solid waste disposal, and certain electric and heating facilities), economic development (small manufacturing facilities and redevelopment in economically depressed areas), and certain social programs (low-income rental housing, qualified mortgage bonds, student loan bonds, and exempt activities of charitable organizations described in Code sec. 501(c)(3)).

Subject to limited exceptions, issuers of tax-exempt bonds are not permitted to earn and retain profits on investment of bond proceeds in a manner unrelated to the governmental purpose of the borrowing (the "arbitrage restrictions"). Profits are defined as earnings in excess of the interest paid on the bonds. The arbitrage restrictions require profits on these nonpurpose investments to be rebated to the Federal Government at five-year intervals, with the final payment being due following redemption of the bonds.

[8] 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.

Present law includes several exceptions to the requirement that arbitrage profits be rebated to the Federal Government:

(1) If all proceeds of an issue of tax-exempt bonds are spent for the governmental purpose of the borrowing within six months after the bonds are issued, no rebate is required for any profits that are earned (e.g., during the six-month period or afterwards on funds such as certain bona fide debt service funds). For governmental bonds, the 100-percent expenditure requirement for the first six months is reduced to 95 percent, if the remaining five percent of the proceeds is spent within one year after the bonds are issued.

(2) In the case of tax and revenue anticipation notes, which are short-term bonds issued to finance governmental cash flow deficits, no rebate is required if the amount of the borrowing does not exceed amounts determined by reference to the issuing government's projected cash flow shortfall.

(3) In the case of governmental bonds and certain private activity bonds issued to finance the construction of property owned by a governmental unit or a section 501(c)(3) organization, no rebate is required (except profits on amounts invested in reserve funds) if proceeds are spent in a manner satisfying a 24-month "spend-down" exception (the "construction bond exception"). The construction bond exception requires expenditure of minimum amounts during each six-month period of the 24-month period (10 percent in the first six months; 45 percent in the first 12 months; 75 percent in the first 18 months; and 100 percent (less retainage not exceeding five percent) by the end of the 24 month period). This exception further allows issuers to elect to pay a fixed penalty in lieu of calculating arbitrage profits and rebating them to the Federal Government if any of the expenditure targets are not met.

(4) In the case of governmental bonds issued by small governments, no rebate is required. "Small" governments are defined as governmental units with general taxing powers that, along with any subordinate units, issue no more than $5 million in governmental bonds during a calendar year. In calculating the $5 million issuance limit, up to $5 million of bonds to finance public school construction may be excluded, effectively increasing the issuance limit to $10 million in the case of small governments engaging in public school construction.

REASONS FOR CHANGE

The Committee is aware that a great need exists for construction and renovation of public schools if American educational excellence is to be maintained. The Committee determined that a more liberal spend-down exception for public school construction bonds is appropriate to allow issuers greater flexibility in the timing of bond issuance for this limited purpose to meet actual construction needs.

EXPLANATION OF PROVISION

The bill liberalizes the permitted expenditure period of the present-law construction bond exception in the case of bonds issued to finance the construction of public schools. Amounts spent for the acquisition and improvement of land that is functionally related and subordinate to a school the construction of which is financed with proceeds of the bond issue are treated as spent for construction. Under the bill, no rebate is required on the construction proceeds of these public school construction bonds if the proceeds (less presently allowed retainage[9]) are spent within four years after the bonds are issued, and the following intermediate spending targets are satisfied:

(1) 10 percent or more of the construction proceeds is spent within one year after the bonds are issued;

(2) 30 percent or more of the construction proceeds is spent within two years after the bonds are issued; and

(3) 50 percent or more of the construction proceeds is spent within three years after the bonds are issued.

As under the present construction bond exception, issuers may elect to pay fixed penalties in lieu of calculating profits and rebating them to the Federal Government if they fail to satisfy the liberalized expenditure requirements. Further, as under the present-law exception, profits earned on reasonably required reserve or replacement funds or on proceeds used other than for construction remain subject to the rebate requirement.

EFFECTIVE DATE

The provision applies to bonds issued after December 31, 1998.

H. Social Security Provisions

1. Increases in the Social Security earnings limit for individuals who have attained retirement age (sec. 121 of the bill and sec. 203 of the Social Security Act)

PRESENT LAW

Senior citizens age 70 and older receive full Social Security benefits regardless of the amount of earnings they have from wages or self employment. Those between the full retirement age (currently age 65) and age 70 receive full benefits only if their earnings are lower than an earnings limit amount determined by law. In 1998, the limit for those age 65 to 69 is $14,500. The limit is gradually raised to $30,000 by the year 2002 as shown in the table below. After 2002, the annual exempt amounts are indexed to growth in average wages.

Year	*Present law earnings limit*
1998	$14,500
1999	15,500
2000	17,000
2001	25,000
2002	30,000
2003	31,231
2004	32,463
2005	33,806
2006	35,149
2007	36,604
2008	37,948

Senior citizens between the age of full retirement (currently age 65) and 70 who earn more than the earnings limit lose $1 in bene-

[9] Retainage amounts, limited to the present-law five percent amount, are required to be spent within five years after the bonds are issued.

fits for every $3 in wages or self-employment income they earn over the limit.

REASON FOR CHANGE

Given the combined effects of Federal, State and local income taxes, Social Security payroll taxes, income taxes on benefits, and the earnings limit, senior citizens who earn even moderate amounts over the limit can be subjected to extremely high marginal tax rates. These rates are a severe disincentive to work and penalize retirees who often need to work out of economic need. Raising the earnings limit also would ease the administrative burdens of the Social Security Administration, which spends between $100 and $150 million a year to monitor and update the earnings limit. SSA estimates that on average 66 percent of all overpayments, and 16 percent of all underpayments, were attributable to the earnings limit.

EXPLANATION OF PROVISION

The bill increases the Social Security earnings limit for those between full retirement age (currently age 65) and age 70 in calendar years 1999–2008, as follows:

Year	*Earnings limit under the bill*
1998	$14,500
1999	17,000
2000	18,500
2001	26,000
2002	30,000
2003	31,300
2004	34,000
2005	35,400
2006	36,800
2007	38,350
2008	39,750

Senior citizens between full retirement age (currently age 65) and 70 who earn over the given earnings limit for the year would continue to lose $1 in benefits for every $3 earned over the limit. After 2008, the annual exempt amounts are indexed to growth in average wages.

EFFECTIVE DATE

The provision is effective for the taxable years ending after 1998.

2. Recomputations of benefits after normal retirement age (sec. 122 of the bill and sec. 215 of the Social Security Act)

PRESENT LAW

Social Security benefits are based on the average of an individual's "high" years of earnings. For workers born in 1929 or later, 35 "high" years of earnings are averaged. For those born before 1929, the number of "high" years averaged is proportionately fewer (for example, for those born in 1919, 25 "high" years are averaged).

If a retiree continues to work after entitlement to benefits, his or her monthly benefit may be increased if the new yearly earnings are greater than one of the years used in the initial determination of benefits. Currently, recomputations of benefits are effective in the year immediately following the year of the earnings. However, because of the lag between when wages are earned and when they are reported and recomputations are processed, most recomputations are actually paid in a lump-sum payment near the end of the year that they are effective. Subsequently, the adjustment is reflected in the new regular monthly benefit amount.

REASON FOR CHANGE

Since earnings are not reported until well into the year following the year in which they are earned, there is no administrative lead time built into the process for SSA to adjust payments on a timely basis. The adjustments almost always have to be provided to beneficiaries through end-of-year lump-sum payments (and are sometimes delayed until the next year). As a result, the current recomputation process is labor intensive for SSA, and because most recipients do not expect these increases, many are confused by receipt of the lump-sum checks. Many of those affected by the delay in recomputation are among those likely to benefit from the proposed increases in the earnings limitation.

Under the provision, SSA's ability to manage the recomputation process will be greatly enhanced by having ample lead time between the year of the earnings and the point at which they are reflected in benefit levels. The benefit check that the recipient relies on to meet regular monthly expenses will not be affected by delaying the recomputation.

Beneficiaries who lack earnings in one or more of the "high" years, and who are therefore most likely to have the lowest Social Security benefits, will receive retroactive recomputations and past-due benefits as under present law.

EXPLANATION OF PROVISION

Recomputation of benefits resulting from earnings in the year after a worker reaches normal retirement age (currently age 65) and later will be reflected in the recipient's benefit check, effective with the January of the second year after the year of the earnings. An exception is provided for recipients who have one or more "zero" years of earnings in their wage averaging computation. Earnings will continue to be credited as under present law for purposes of establishing entitlement.

EFFECTIVE DATE

The provision is effective for earnings beginning in 1998.

TITLE II. SMALL BUSINESS AND FARMER TAX RELIEF PROVISIONS

A. ACCELERATE INCREASE IN EXPENSING FOR SMALL BUSINESSES (SEC. 201 OF THE BILL AND SEC. 179 OF THE CODE)

PRESENT LAW

Present law provides that, in lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to $18,500 (for taxable years beginning in 1998) of the cost of qualifying property placed in service for the taxable year (sec. 179). In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The $18,500 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

The $18,500 amount is increased to $25,000 for taxable years beginning in 2003 and thereafter. The increase is phased in as follows: for taxable years beginning in 1999, the amount is $19,000; for taxable years beginning in 2000, the amount is $20,000; for taxable years beginning in 2001 or 2002, the amount is $24,000; and for taxable years beginning in 2003 and thereafter, the amount is $25,000.

REASONS FOR CHANGE

The Committee believes that section 179 expensing provides two important benefits for small businesses (including small businesses that are farms). First, it lowers the cost of capital for tangible property used in a trade or business. Second, it eliminates depreciation recordkeeping requirements with respect to expensed property. In the Small Business Job Protection Act of 1996, the Congress increased the value of these benefits over a phase-in period ending in 2003. The Committee now believes that the value of the benefits should be increased for taxable years beginning in 1999 and thereafter, without a phase-in period, so that taxpayers may receive these benefits earlier.

EXPLANATION OF PROVISION

The bill provides that the maximum dollar amount that may be deducted under section 179 is increased to $25,000 for taxable years beginning in 1999 and thereafter, without the present-law phase-in rule.

The Treasury Department is requested to conduct a comprehensive study of recovery periods and depreciation methods under section 168 of the Code for purposes of the deduction for depreciation and to provide recommendations as to the determination of such periods and methods in a more rational manner.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 1998.

B. Farm Provisions

1. Permanent extension of income averaging for farmers (sec. 211 of the bill and sec. 1301 of the Code)

PRESENT LAW

An individual engaged in a farming business may elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or a portion of the taxable income that is attributable to the farming business.

In general, an individual who makes the election (1) designates all or a portion of his or her taxable income attributable to any farming business from the current year as "elected farm income;"[10] (2) allocates one-third of the elected farm income to each of the three prior taxable years; and (3) determines the current year section 1 tax liability by combining (a) his or her current year section 1 tax liability excluding the elected farm income allocated to the three prior taxable years, plus (b) the increases in the section 1 tax liability for each of the three prior taxable years caused by including one-third of the elected farm income in each such year. Any allocation of elected farm income pursuant to the election applies 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. The provision also does not apply for purposes of the alternative minimum tax. The provision is effective for taxable years beginning after December 31, 1997, and before January 1, 2001.

REASONS FOR CHANGE

Income from a farming business can fluctuate significantly from year to year due to circumstances beyond the farmer's control. Allowing farmers an election to average their income over a period of years mitigates the adverse tax consequences that could result from fluctuating income levels. The Committee believes that the election by farmers to average their income should be made permanent.

EXPLANATION OF PROVISION

The bill permanently extends the income averaging provision for farmers.

EFFECTIVE DATE

The provision is effective for taxable years beginning after December 31, 2000.

2. Extend the net operating loss carryback period for farmers (sec. 212 of the bill and sec. 172 of the Code)

PRESENT LAW

A net operating loss ("NOL") is, generally, the amount by which business deductions of a taxpayer exceed business gross income. An

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[10] The amount of elected farm income of a taxpayer for a taxable year may not exceed the taxable income attributable to any farming business for the year.

NOL may be carried back two years and carried forward 20 years to offset taxable income in such years. A taxpayer may elect to forgo the carryback of an NOL. In the case of an NOL (1) arising from casualty or theft losses of individual taxpayers, or (2) attributable to Presidentially declared disasters for taxpayers engaged in a farming business or a small business, the NOL can be carried back three years. A farming business includes the trade or business of farming, as well as the trade or business of operating a nursery or sod farm, or the raising or harvesting of certain trees.[11] Special rules apply to real estate investment trusts (no carrybacks), specified liability losses (10-year carryback), and excess interest losses (no carrybacks).

A carry back of an NOL will result in the refund of Federal income tax for the carryback year. A carryforward of an NOL will reduce Federal income tax for the carryforward year.

REASONS FOR CHANGE

The NOL carryback and carryforward rules allow taxpayers to smooth out swings in business income (and Federal income taxes thereon) that result from business cycle fluctuations and unexpected financial losses. Farmers are particularly vulnerable to such fluctuations and losses. The Committee believes that farmers who suffer losses from their farming business should have an extended period in which to use such losses to offset taxable income in prior years.

EXPLANATION OF PROVISION

The bill provides a special five-year carryback period for a farming loss, regardless of whether the loss was incurred in a Presidentially declared disaster area. The carryforward period remains at 20 years. A "farming loss" is defined as the amount of any net operating loss attributable to the income and deductions of a farming business (as defined in section 263A(e)(4)). A farming loss cannot exceed the taxpayer's NOL for the taxable year. In calculating the amount of a taxpayer's NOL carrybacks, the portion of the NOL that is attributable to a farming loss is treated as a separate NOL and is taken into account after the remaining portion of the NOL for the taxable year.

A taxpayer can elect to forgo the five-year carryback period for a farming loss. The election to forgo the five-year carryback period is made in the manner prescribed by the Secretary of the Treasury and must be made by the due date of the return (including extensions) for the year of the loss. The election is irrevocable. If a taxpayer elects to forgo the five-year carryback period, then the farming losses are subject to the rules that otherwise would have applied under section 172 absent the five-year rule. The three-year carryback period continues to apply to an NOL incurred in a Presidentially declared disaster area if such NOL is not eligible for the five-year carryback period.

[11] For this purpose, the term "farming business" is defined as in sec. 263A(e)(4).

EFFECTIVE DATE

The provision is effective for NOLs arising in taxable years beginning after December 31, 1997.

3. Production flexibility contract payments (sec. 213 of the bill)

PRESENT LAW

A taxpayer is generally required to include an item in income no later than the time of its actual or constructive receipt, unless such amount is properly accounted for as of a different period under the taxpayer's method of accounting. If a taxpayer has an unrestricted right to demand the payment of an amount, the taxpayer is in constructive receipt of that amount whether or not the taxpayer makes the demand and actually receives the payment.

The Federal Agriculture Improvement and Reform Act of 1996 provides for certain annual payments to be made to certain farmers. These payments are made at specified times during the fiscal year. The Emergency Farm Financial Relief Act of 1998 provides that all payments for fiscal year 1999 are to be paid at such time or times during fiscal year 1999 as the recipient may specify. Amounts that would otherwise be paid after December 31, 1998 can be specified for payment in calendar year 1998. This potentially results in the constructive receipt (and thus required inclusion in taxable income) of such amounts in calendar year 1998, whether or not the amounts are actually received or the right to their receipt is fixed.

REASONS FOR CHANGE

The Committee believes that it is inappropriate to accelerate the tax on Federal Agriculture Improvement and Reform Act of 1996 payments where the taxpayer does not accelerate the actual receipt of such payments.

EXPLANATION OF PROVISION

The option added by the Emergency Farm Financial Relief Act of 1998 to accelerate certain payments under the Federal Agriculture Improvement and Reform Act of 1996 that are due in fiscal 1999 is disregarded in determining the taxable year in which such payments must be included in income.

EFFECTIVE DATE

The provision is effective for Federal Agriculture Improvement and Reform Act of 1996 payments for fiscal year 1999.

C. Increase in Volume Cap on Private Activity Bonds (sec. 221 of the bill and sec. 146 of the Code)

PRESENT LAW

Interest on bonds issued by States and local governments is excluded from income if the proceeds of the bonds are used to finance activities conducted and paid for by the governmental units (Code sec. 103). Interest on bonds issued by these governmental units to finance activities carried out and paid for by private persons ("private activity bonds") is taxable unless the activities are specified in the Internal Revenue Code. Private activity bonds on which interest may be tax-exempt include bonds for privately operated transportation facilities (airports, docks and wharves, mass transit, and high-speed rail facilities), privately owned and/or provided municipal services (water, sewer, solid waste disposal, and certain electric and heating facilities), economic development (small manufacturing facilities and redevelopment in economically depressed areas), and certain social programs (low-income rental housing, qualified mortgage bonds, student loan bonds, and exempt activities of charitable organizations described in Code sec. 501(c)(3)).

The volume of tax-exempt private activity bonds that States and local governments may issue for most of these purposes in each calendar year is limited by State-wide volume limits. The current annual volume limits are $50 per resident of the State or $150 million if greater. The volume limits do not apply to private activity bonds to finance airports, docks and wharves, certain governmentally owned, but privately operated solid waste disposal facilities, certain high-speed rail facilities, and to certain types of private activity tax-exempt bonds that are subject to other limits on their volume (qualified veterans' mortgage bonds and certain "new" empowerment zone and enterprise community bonds).

REASONS FOR CHANGE

The Committee determined that an adjustment to the annual State private activity bond volume limits to levels comparable to the dollar limits that first applied after enactment of the Tax Reform Act of 1986 is appropriate. Such an adjustment will assist States in meeting infrastructure needs and encouraging economic development and will facilitate continuation of privatization efforts regarding municipal services such as solid waste disposal, water, and sewer services without reversing the general policy of limiting the use of this Federal subsidy for conduit borrowing in transactions that distort market choice and efficiency.

EXPLANATION OF PROVISION

The bill increases the present-law annual State private activity bond volume limits by 50 percent, to $75 per resident of each State (or $225 million if greater).

EFFECTIVE DATE

The provision is effective beginning in calendar year 1999.

TITLE III. EXTENSION OF EXPIRING PROVISIONS

A. Extension of Research and Experimentation Credit and Increase in the Rates for the Alternative Incremental Research Credit (sec. 301 of the bill and sec. 41 of the Code)

PRESENT AND PRIOR 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 does not apply to amounts paid or incurred after June 30, 1998.

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.[12]

In computing the credit, a taxpayer's base amount may not be less than 50 percent of its current-year qualified research expenditures.

[12] A special rule 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 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-based 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-based 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)).

Alternative incremental research credit regime

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 for any taxable year beginning after June 30, 1996, 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.

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").[13]

To be eligible for the credit, the research must not only satisfy the requirements of present-law section 174 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 involve a process of experimentation related to functional aspects, performance, reliability, or quality of a business component.

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).

[13] Under a special rule, 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 sec. 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.

Relation to deduction

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)).

REASONS FOR CHANGE

The Committee believes that increasing technological knowledge ultimately will lead to new and better products produced at lower costs. New and better products and lower production costs are the genesis of economic growth. For this reason, the Committee believes it is important to extend the research and experimentation tax credit.

In addition, the Committee believes the alternative incremental credit enacted in 1996 should be strengthened. The alternative incremental research credit was enacted to respond to the changing economic circumstances of many taxpayers which invest heavily in research. However, the Committee believes that under current law, the alternative incremental research credit provides less of a research incentive than does the regular research and experimentation tax credit. Therefore, the Committee believes it is appropriate to increase the rate of the alternative incremental research credit.

EXPLANATION OF PROVISION

The bill extends the research tax credit for 20 months—i.e., generally, for the period July 1, 1998, through February 29, 2000.

In addition, the bill increases the credit rate applicable under the alternative incremental research credit one percentage point per step, that is from 1.65 percent to 2.65 percent when a taxpayer's current-year research expenses exceed a base amount of 1 percent but do not exceed a base amount of 1.5 percent; from 2.2 percent to 3.2 percent when a taxpayer's current-year research expenses exceed a base amount of 1.5 percent but do not exceed a base amount of 2 percent; and from 2.75 percent to 3.75 percent when a taxpayer's current-year research expenses exceed a base amount of 2 percent.

In extending the credit, the Committee wishes to reaffirm the scope of the term "qualified research." Section 41 targets the credit to research which is undertaken for the purpose of discovering information which is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer. However, eligibility for the credit does not require that the research be successful—i.e., the research need not achieve its desired result. Moreover, evolutionary research activities intended to improve functionality, performance, reliability, or quality are eligible for the credit, as are research activities intended to achieve a result that has already been achieved by other persons but is not yet within the common knowledge e.g., freely available to the general public) of the field (provided that the research otherwise meets the requirements of section 41, including not being excluded by subsection (d)(4)).

Activities constitute a process of experimentation, as required for credit eligibility, if they involve evaluation of more than one alternative to achieve a result where the means of achieving the result are uncertain at the outset, even if the taxpayer knows at the outset that it may be technically possible to achieve the result. Thus, even though a researcher may know of a particular method of achieving an outcome, the use of the process of experimentation to effect a new or better method of achieving that outcome may be eligible for the credit (provided that the research otherwise meets the requirements of section 41, including not being excluded by subsection (d)(4)).

Lastly, the Committee observes a lack of clarity in and litigation regarding the definition of "internal-use software." The Committee believes that taxpayers should be given clear guidance as to what software is not subject to the limitations on expenditures related to "internal-use software" for purposes of the research tax credit. As such, the Committee encourages the Secretary of the Treasury to issue regulations that clarify the distinction between internal-use software, which is subject to a higher standard for eligibility for the credit, and other software, which is not subject to the higher standards of Code section 41(d)(4)(E).

EFFECTIVE DATE

The extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1998, through February 29, 2000. The increase in the credit rate under the alternative incremental research credit is effective for taxable years beginning after June 30, 1998.

B. Extension of the Work Opportunity Tax Credit (sec. 302 of the bill and sec. 51 of the Code)

PRIOR LAW

In general

The work opportunity tax credit ("WOTC"), which expired on June 30, 1998, was available on an elective basis for employers hiring individuals from one or more of eight targeted groups. The credit equals 40 percent (25 percent for employment of 400 hours or less) of qualified wages. Qualified wages are wages attributable to service rendered by a member of a targeted group during the one-year period beginning with the day the individual began work for the employer. For a vocational rehabilitation referral, however, the period begins on the day the individual began work for the employer on or after the beginning of the individual's vocational rehabilitation plan.

The maximum credit per employee is $2,400 (40 percent of the first $6,000 of qualified first-year wages). With respect to qualified summer youth employees, the maximum credit is $1,200 (40 percent of the first $3,000 of qualified first-year wages).

The employer's deduction for wages is reduced by the amount of the credit.

Targeted groups eligible for the credit

The eight targeted groups are: (1) families eligible to receive benefits under the Temporary Assistance for Needy Families (TANF) Program; (2) high-risk youth; (3) qualified ex-felons; (4) vocational rehabilitation referrals; (5) qualified summer youth employees; (6) qualified veterans; (7) families receiving food stamps; and (8) persons receiving certain Supplemental Security Income (SSI) benefits.

Minimum employment period

No credit is allowed for wages paid to employees who work less then 120 hours in the first year of employment.

Expiration date

The credit was effective for wages paid or incurred to a qualified individual who began work for an employer before July 1, 1998.

REASONS FOR CHANGE

The Committee believes the preliminary experience of the WOTC is promising as an incentive for employers to hire individuals who are under-skilled, undereducated, or who generally may be less desirable to employers. A temporary extension of this credit will allow the Congress and the Treasury and Labor Departments to continue to monitor the effectiveness of the credit.

EXPLANATION OF PROVISION

The bill extends the work opportunity tax credit for 20 months (through February 29, 2000).

EFFECTIVE DATE

The provision is effective for wages paid or incurred to qualified individuals who begin work for the employer on or after July 1, 1998, and before March 1, 2000.

C. Extension of the Welfare-To-Work Tax Credit (sec. 303 of the bill and sec. 51A of the Code)

PRESENT LAW

Employers are allowed a tax credit for eligible wages paid to qualified long-term family assistance 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 have received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that have received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit (August 5, 1997) 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 two 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.

The welfare-to-work credit 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.

REASONS FOR CHANGE

The Committee believes that the credit should be temporarily extended to provide the Congress and the Treasury and Labor Departments a better opportunity to assess the operation and effectiveness of the credit in meeting its goals. When enacted in the Taxpayer Relief Act of 1997, the goals of the welfare-to-work credit were: (1) to provide an incentive to hire long-term welfare recipients; (2) to promote the transition from welfare to work by increasing access to employment; and (3) to encourage employers to provide these individuals with training, health coverage, dependent care and ultimately better job attachment.

EXPLANATION OF PROVISION

The bill extends the welfare-to-work credit for an additional 10 months (through February 29, 2000.

EFFECTIVE DATE

The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after May 1, 1999, and before March 1, 2000.

D. Extend the Deduction Provided for Contributions of Appreciated Stock to Private Foundations; Public Inspection of Private Foundation Annual Returns

1. Extend the deduction provided for contributions of appreciated stock to private foundations (sec. 304(a) of the bill and sec. 170(e)(5) of the Code)

PRESENT AND PRIOR 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.[14] 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 de-

[14] 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)).

duction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose.

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 July 1, 1998. 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.

REASONS FOR CHANGE

The Committee believes that, to encourage donations to charitable private foundations, it is appropriate to extend permanently the rule that allows a fair market value deduction for certain gifts of appreciated stock to private foundations.

EXPLANATION OF PROVISION

The provision extends permanently the special rule contained in section 170(e)(5).

EFFECTIVE DATE

The provision is effective for contributions of qualified appreciated stock to private foundations made on or after July 1, 1998.

2. Public inspection of private foundation annual returns (sec. 304(b) of the bill and sec. 6104 of the Code)

PRESENT LAW

Tax-exempt organizations (other than churches and certain small organizations) are required to file an annual information return (Form 990) with the Internal Revenue Service ("IRS"), setting forth the organization's items of gross income and expenses attributable to such income, disbursements for tax-exempt purposes, plus certain other information for the taxable year.

Private foundations are required to make the current year's annual information return (Form 990–PF) available for public inspection at the foundation's principal office during regular business hours (sec. 6104(d)). Such return must be made available for inspection by any citizen on request made within 180 days after the date of publication of notice of its availability. Notice must be published, not later than the day the return is required to be filed, in a newspaper having general circulation in the county in which the principal office of the foundation is located. The notice must state that the annual return is available for public inspection by any citizen who requests it, and must state the address and telephone number of the private foundation's principal office and the name of its principal manager.

Tax-exempt organizations (other than private foundations) that are required to file a Form 990, including public charities, are required to allow public inspection at the organization's principal office (and certain regional or district offices) of their Forms 990 for the three most recent taxable years (sec. 6104(e)).

The Taxpayer Bill of Rights 2 imposed additional public inspection requirements on tax-exempt organizations. All tax-exempt organizations, except private foundations, will be required to comply with requests made in person or in writing by individuals who seek a copy of the organization's Form 990 for any of the organization's three most recent taxable years. Upon such a request, the organization is required to supply copies without charge other than a reasonable fee for reproduction and mailing costs. If the request for copies is made in person, then the organization must immediately provide such copies. If the request for copies is made in writing, then copies must be provided within 30 days. In addition, all tax-exempt organizations, including private foundations, will be required to comply in the same manner with requests made in person or in writing by individuals who seek a copy of the organization's application for recognition of tax-exempt status and certain related documents. However, an organization may be relieved of its obligation to provide copies if, in accordance with regulations to be promulgated by the Secretary of Treasury, (1) the organization has made the requested documents widely available or (2) the Secretary of the Treasury determined, upon application by the organization, that the organization was subject to a harassment campaign such that a waiver of the obligation to provide copies would be in the public interest. These additional public inspection provisions apply to requests made no earlier than 60 days after the date on which the Treasury Department publishes regulations defining when requested documents have been made widely available or when a request is part of a harassment campaign, but in any event, not before December 31, 1998.[15] While proposed regulations have been issued, final regulations have not been published; therefore, the provision is not yet in effect.[16]

Upon written request to the IRS, members of the general public also are permitted to inspect annual information returns of tax-exempt organizations and applications for recognition of tax-exempt status (and related documents) at the National Office of the IRS in Washington, D.C. A person making such a written request is notified by the IRS when the material is available for inspection at the National Office, where notes may be taken of the material open for inspection, photographs taken with the person's own equipment, or copies of such material obtained from the IRS for a fee (Treas. Reg. secs. 301.6104(a)–6 and 301.6104(b)–1).

[15] However, the legislative history of the provision indicates that Congress expected that organizations will comply voluntarily with the public inspection provisions prior to the issuance of such final regulations.

[16] Prop. Treas. Reg. sec. 301.6104(e)–1.

REASONS FOR CHANGE

To enhance oversight and public accountability of non-profit organizations, the Committee believes that the disclosure provisions applicable to private foundations should be consistent with those applicable to public charities and other tax-exempt organizations. In addition, this change will result in more efficient use of private foundation resources by eliminating the present-law publication requirements.

EXPLANATION OF PROVISION

Under the provision, private foundations are subject to the public inspection requirements that currently apply to public charities and all other tax-exempt organizations that file annual information returns. Accordingly, private foundations will be required to comply with requests from individuals who seek a copy of the foundation's annual information return for any of the foundation's three most recent taxable years. Private foundations are no longer subject to the publication requirements of section 6104(d).

The Committee is aware that the length of annual information returns filed by certain private foundations may make duplication and mailing of the return expensive and administratively burdensome. The Committee expects that the Treasury Department will publish regulations to address this issue (e.g., by permitting persons to request a copy of particular portions of the return).

EFFECTIVE DATE

The additional public inspection provisions apply to requests made after the later of: (1) the date which is 60 days after the date on which the Treasury Department publishes regulations defining when requested documents have been made widely available or when a request is part of a harassment campaign, or (2) December 31, 1998. The repeal of the present-law publication requirement shall apply only to those returns the due date for filing of which is on or after the date the public inspection requirements become effective.

E. Exceptions Under Subpart F for Certain Active Financing Income (sec. 305 of the bill and secs. 953 and 954 of the Code)

PRESENT LAW

In general

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: (1) dividends, interest, royalties, rents and annuities; (2) net gains from the sale or exchange of (a) property that gives rise to the preceding types of income, (b) property that does not give rise to income, and (c) interests in trusts, partnerships, and REMICs; (3) net gains from commodities transactions; (4) net gains from foreign currency transactions; (5) income that is equivalent to interest; (6) income from notional principal contracts; and (7) payments in lieu of dividends.

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. 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)).

Temporary exceptions from foreign personal holding company income and foreign base company services income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, insurance, or similar business. These exceptions (described below) are applicable only for taxable years beginning in 1998.

Income from the active conduct of a banking, financing, or similar business

A 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. In this regard, 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) (as in effect prior to the enactment of the Taxpayer Relief Act of 1997). See Prop. Treas. Reg. secs. 1.1296–4 and 1.1296–6. The Secretary of the Treasury is directed to prescribe regulations applying look-through treatment in characterizing for this purpose dividends, interest, income equivalent to interest, rents and royalties from related persons.

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, a corporation is 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 prior law section 1296(b) (as in effect prior to the enactment of the Taxpayer Relief Act of 1997); qualified bank affiliates and qualified securities affiliates are 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 ("QBU") of a corporation from transactions with unrelated persons located in the country in which the QBU 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.

Income from the active conduct of an insurance business

A temporary exception from foreign personal holding company income applies for certain investment income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization. These rules differ from the rules of 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.

A temporary exception applies 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. 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 are defined as 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 apply. Any one of the three rules can be elected with respect to a particular line of business.

First, reserves for such contracts can 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 can be determined 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 can be determined to be equal to the net surrender value of the contract (as defined in section 807(e)(1)(A)).

In no event can 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.

A temporary exception from foreign personal holding company income also applies 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. In general, 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. In the event of the acquisition of a book of business from another company through an assumption or indemnity reinsurance transaction, the 5-year 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. Reinsurance transactions among related persons may not be used to multiply the number of 5-year periods.

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 sec. 817), only the income specifically allocable to such contracts are taken into account. In the case of other contracts, income not specifically allocable is allocated ratably among such contracts.

A qualifying insurance company is defined as 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 temporary exceptions do not apply to investment income (includable in the income of a U.S. shareholder of a CFC pursuant to sec. 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.

Anti-abuse rule

An anti-abuse rule applies for purposes of these temporary exceptions. For purposes of applying these exceptions, items with respect to a transaction or series of transactions are 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.

Foreign base company services income

A temporary exception from foreign base company services income applies 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 or is a qualifying insurance company.

REASONS FOR CHANGE

The subpart F rules historically have been aimed at requiring current inclusion by the U.S. shareholders of income of a CFC that is either passive or easily moveable. Under the subpart F rules, certain U.S. shareholders of a CFC are subject to U.S. tax on a current basis on certain income (including certain insurance income and foreign personal holding company income) earned by the CFC, whether or not such income is distributed to the shareholders. Prior to the enactment of the Tax Reform Act of 1986 (the "1986 Act"), exceptions from foreign personal holding company income were provided for income derived in the active conduct of a banking, financing, or similar business, or derived from certain investments made by an insurance company. The Committee recognizes that the 1986 Act's repeal of these exceptions may be viewed as causing the subpart F rules to apply to income that is neither passive nor easily moveable, requiring inclusion of such income on a current basis by U.S. shareholders. In the Taxpayer Relief Act of 1997, a one-year temporary exception from foreign personal holding company income was enacted[17] for income from the active conduct of an insurance, banking, financing, or similar business. The Committee believes it is appropriate to extend for one year these exceptions from subpart F, with certain modifications.

The Committee believes that modifications to the present-law provision are appropriate, including changes designed to treat various types of businesses with active financing income more similarly to each other than does the present-law provision. The Committee also believes that it is appropriate to modify the present-law provision to require that eligible businesses conduct substantial activity with regard to their respective financial service businesses, and that the income eligible for the exceptions have a nexus with the business activities giving rise to such income. In the case of transactions conducted with persons located outside the home country of the CFC or its foreign branch (so-called "cross border" transactions), the Committee believes that it is appropriate to impose higher standards for qualifying under the provision due to the increased concerns with respect to the mobility of income from such transactions.

EXPLANATION OF PROVISION

In general

The bill extends and modifies the present-law temporary exceptions from subpart F for income that is derived in the active conduct of a banking, financing, or similar business or in the conduct of an insurance business. These exceptions (as modified) are applicable only for taxable years beginning in 1999.

With respect to income derived in the active conduct of a banking, financing, or similar business, the bill differs from the present-law temporary exceptions in the following significant respects. First, the bill requires a CFC to conduct substantial activity with respect to its business in order to qualify for the exceptions. Second, the bill adds certain nexus requirements which require that income which is derived by a CFC or QBU from transactions with customers is eligible for the exceptions if, among other things, substantially all of the activities in connection with such transactions are conducted directly by the CFC or QBU in its home country, and such income is treated as earned by the CFC or QBU in its home country for purposes of such country's tax laws. Third, the bill modifies the tests for determining whether a CFC is predominantly engaged in the active conduct of a banking, financing, or similar business, including modifications for income derived from a lending or finance business. Fourth, the bill extends the exceptions to income derived from certain cross border transactions, provided that certain requirements are met. Fifth, the determination of where a customer is treated as located is made under rules prescribed by the Secretary of the Treasury. Finally, the look-through rule that

[17] The President canceled this provision in 1997 pursuant to the Line Item Veto Act. On June 25, 1998, the U.S. Supreme Court held that the cancellation procedures set forth in the Line Item Veto Act are unconstitutional. *Clinton* v. *City of New York,* 118 S. Ct. 2091 (June 25, 1998).

was included in the present-law provision for purposes of determining the income eligible for the exceptions is eliminated.

In the case of insurance, the bill differs from present law in the following significant respects. In addition to the exception for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization that is provided under present law, the bill provides additional exceptions. First, the bill provides temporary exceptions from insurance income and from foreign personal holding company income for certain income of a qualifying branch of a qualifying insurance company with respect to risks located within the home country of the branch, provided certain requirements are met under each of the exceptions. Further, the bill adds additional temporary exceptions from insurance income and from foreign personal holding company income for certain income of certain CFCs or branches with respect to risks located in any country other than the United States, provided that the requirements for these exceptions are met.

Income from the active conduct of a banking, financing or similar business

Substantial activity requirement

The bill modifies the exceptions from subpart F for income derived in the active conduct of a banking, financing, or similar business by, among other things, incorporating a substantial activity requirement. Under the bill, the subpart F exceptions apply to a CFC that is an eligible controlled foreign corporation (an "eligible CFC'). An eligible CFC is defined as a CFC which is predominantly engaged in the active conduct of a banking, financing, or similar business, but only if it conducts substantial activity with respect to such business.

Whether a CFC is considered to conduct substantial activity with respect to a banking, financing, or similar business is determined under all the facts and circumstances. It is intended that as part of this facts and circumstances analysis in determining whether the activities conducted by the CFC are substantial, all relevant factors are taken into account, including the overall size of the CFC, the amount of its revenues and expenses, the number of its employees, the ratio of its revenues per employee, the amount of property it owns, and the nature, size, and relative significance of the applicable activities conducted by the CFC. Under the bill, the Secretary is granted the authority to prescribe regulations to carry out the purposes of these exceptions. It is intended that such authority includes the authority to prescribe rules relating to whether a CFC (or, as relevant, a QBU) is considered to conduct substantial activity.

It also is intended that as part of this facts and circumstances analysis, a CFC is required to conduct substantially all of the activities necessary for the generation of income with respect to the business, which generally include the following:

Initial solicitation of customers (including vendors);

Advising customers on financial needs, including funding and financial products;

Providing financial and technical advice to customers;

Designing or tailoring financial products to customers' needs;
Negotiating terms with customers;
Performing credit analysis on customers and evaluating non-credit risks;
Providing related services to customers;
Making loans, entering into leases, extending credit or entering into other transactions with customers that generate income that would be considered derived in the active conduct of a banking, financing, or similar business;
Collecting from customers;
Performing remarketing activities (including sales) following termination of transactions with customers;
Responding to customers failure to satisfy their obligations under transactions, including enforcement or renegotiation of terms, liquidation of collateral, foreclosure, and/or institution of litigation; and
Holding collateral for transactions with customers.

It is intended that the performance of back-office functions (including accounting for income or loss, recordkeeping, and routine communicating with customers) not be taken into account in determining whether the substantial activity requirement is satisfied. It also is intended that the relevant activities of the business may be modified by Treasury regulation to take into account future changes in the operations of these businesses.

In general, the substantial activity requirement is applied based on the activities of the CFC as a whole, including the activities of any QBUs of the CFC. In determining whether the substantial activity requirement is satisfied, activities performed in the country in which the CFC is incorporated (or in the country in which the QBU has its principal office) by employees of a related person of the CFC are taken into account, but only to the extent that the related person is compensated on an arm's-length basis for the services of such employees and such compensation is includible in the related person's income in such country for purposes of such country's income tax laws. For this purpose, a related person has the meaning provided in section 954(d)(3), substituting "at least 80 percent" for "more than 50 percent." It is intended that the activities of such a related person would not again be taken into account in determining whether another CFC or QBU (e.g., the related person) satisfies the substantial activity requirement.

Predominantly engaged requirement

The bill also modifies the rules for determining whether a CFC is predominantly engaged in the active conduct of a banking, financing, or similar business. Alternative rules apply for this purpose.

Banking or securities business.—The bill modifies the present-law application of the banking or securities business tests for determining whether a CFC is predominantly engaged in the active conduct of a banking, financing or similar business. Under the bill, a CFC 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 business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified in regulations). In addition, a CFC 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 securities business and is registered as a securities broker or dealer under applicable U.S. securities laws (or is any other corporation not so registered which is specified in regulations). It generally is intended that these requirements for the active conduct of a banking or securities business are to be interpreted in the manner provided in the regulations proposed under prior law section 1296(b) (as in effect prior to the enactment of the Taxpayer Relief Act of 1997). See Prop. Treas. Reg. secs. 1.1296–4 and 1.1296–6. Specifically, it is intended that these requirements include the requirements for foreign banks under Prop. Treas. Reg. sec. 1.1296–4 as currently drafted. However, it is not intended that these requirements be considered to be satisfied by a CFC merely because it is a qualified bank affiliate or a qualified securities affiliate within the meaning of the proposed regulations under former section 1296(b).

Lending or finance business.—The bill modifies the present-law 70 percent test for determining whether a CFC is predominantly engaged in the active conduct of a banking, financing, or similar business. Under the bill, a CFC is considered to be predominantly engaged in the active conduct of such business if more than 70 percent of its gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are unrelated persons. For this purpose, it is intended that transactions with customers located in the United States not be taken into account in determining whether the 70-percent test is satisfied.

For this purpose, a CFC is considered to be engaged in a lending or finance business if it is engaged in the business of:

(1) making loans;

(2) purchasing or discounting accounts receivable, notes (including loans), or installment obligations;

(3) engaging in leasing (including entering into leases and purchasing, servicing and disposing of leases and leased assets);

(4) issuing letters of credit and providing guarantees;

(5) providing charge and credit card services; or

(6) rendering services or making facilities available in connection with the foregoing activities carried on by the corporation rendering such services or facilities, or by another corporation which is a member of the same affiliated group.

For this purpose, whether two corporations are affiliated is determined by reference to section 1504 with one modification: the exclusion for foreign corporations is disregarded.

Whether any portion of a CFC's gross income is derived directly from the active and regular conduct of a lending or finance business is determined under all the facts and circumstances. Under the bill, the Secretary is granted the authority to prescribe regulations to carry out the purposes of these exceptions. It is intended that such authority includes the authority to prescribe rules relating to this determination.

Qualified banking or financing income exempt from subpart F

In general.—If a CFC is treated as an eligible CFC (i.e., it satisfies the substantial activity and predominantly engaged requirements), the subpart F exceptions apply to qualified banking or financing income of such corporation. Qualified banking or financing income is defined as income which is derived in the active conduct of a banking, financing, or similar business by an eligible CFC or a QBU of such CFC if: (1) the income is derived from transactions with customers not located in the United States, (2) substantially all of the activities in connection with such transactions are conducted directly by the corporation or unit in its home country, and (3) the income is treated as earned by such corporation or unit in its home country for purposes of such country's tax laws. For this purpose, income is considered to be earned by a CFC or a QBU in its home country if such income is sourced and allocable to such CFC or QBU in its home country for purposes of such country's tax laws. In addition, for this purpose, activities are considered to be conducted by a CFC or QBU if such activities are performed by employees of the CFC or QBU. Except as provided by regulations, a CFC's home country is defined as its country of creation or organization, and a QBU's home country is defined as the country in which the unit maintains its principal office. Moreover, income derived from transactions with customers apply only to transactions with customers acting in their capacity as such.

For this purpose, it is intended that income derived by an eligible CFC or QBU of such CFC from the following types of activities be considered to be income derived in the active conduct of a banking, financing, or similar business (provided that the other requirements for these exceptions are satisfied):

(1) regularly making personal, mortgage, industrial, or other loans in the ordinary course of the corporation's trade or business;

(2) factoring evidences of indebtedness for customers;

(3) purchasing, selling, discounting, or negotiating for customers notes, drafts, checks, bills of exchange, acceptances, or other evidences of indebtedness;

(4) issuing letters of credit and negotiating drafts drawn thereunder for customers;

(5) performing trust services, including as a fiduciary, agent, or custodian, for customers, provided such trust activities are not performed in connection with services provided by a dealer in stock, securities or similar financial instruments;

(6) arranging foreign exchange transactions (including any section 988 transaction within the meaning of section 988(c)(1)) for, or engaging in foreign exchange transactions with, customers;

(7) arranging interest rate or currency futures, forwards, options or notional principal contracts for, or entering into such transactions with, customers;

(8) underwriting issues of stock, debt instruments or other securities under best efforts or firm commitment agreements for customers;

(9) engaging in leasing (including entering into leases and purchasing, servicing and disposing of leases and leased assets);

(10) providing charge and credit card services for customers or factoring receivables obtained in the course of providing such services;

(11) providing traveler's check and money order services for customers;

(12) providing correspondent bank services for customers;

(13) providing paying agency and collection agency services for customers;

(14) maintaining restricted reserves (including money or securities) in a segregated account in order to satisfy a capital or reserve requirement imposed by a local banking or securities regulatory authority;

(15) engaging in hedging activities directly related to another activity described herein;

(16) repackaging mortgages and other financial assets into securities and servicing activities with respect to such assets (including the accrual of interest incidental to such activity);

(17) engaging in financing activities typically provided in the ordinary course by an investment bank, such as project financing provided in connection with construction projects, structured finance (including the extension of a loan and the sale of participations or interests in the loan to other financial institutions or investors), and leasing activities to the extent incidental to such financing activities;

(18) providing financial or investment advisory services, investment management services, fiduciary services, or custodial services;

(19) purchasing or selling stock, debt instruments, interest rate or currency futures or other securities or derivative financial products (including notional principal contracts) from or to customers and holding stock, debt instruments and other securities as inventory for sale to customers, unless the relevant securities or derivative financial products are not held in a dealer capacity;

(20) effecting transactions in securities for customers as a securities broker; and

(21) any other activity that the Secretary of the Treasury determines to be a financing activity conducted by active corporations in the ordinary course of their business.

Qualified banking or financing income of an eligible CFC or QBU of such CFC is determined separately for the CFC and each QBU, taking into account, in the case of an eligible CFC, only items of income, gain, deduction, loss or other items, as well as activities, of such CFC that are not properly allocable to any QBUs. Similarly, in the case of a QBU, qualified banking or financing income is determined by taking into account such applicable items (e.g., income and activities) that are properly allocable to such QBU. Under the bill, the Secretary is granted the authority to prescribe regulations to carry out the purposes of these exceptions. It is intended that such authority includes the authority to prescribe rules for properly allocating items and activities among branches or units of a CFC, and between the CFC and its branches or units.

Income from local customer transactions.—If the requirements above are satisfied, the exceptions apply to income that is derived from transactions with customers located in the CFC's home country. In addition, the exceptions apply to income that is derived by a QBU of an eligible CFC from transactions with customers located in the QBU's home country.

For example, assume that a CFC is incorporated in the United Kingdom and has operations in France that constitute a QBU. Also assume that the activities of the U.K. CFC's head office together with the activities of the French QBU satisfy the substantial activity requirement. Under the bill, income derived by the U.K. CFC from transactions with customers in the United Kingdom is eligible for the exceptions if substantially all of the activities in connection with the transaction are performed in the United Kingdom by employees of the U.K. CFC, and the income is treated as earned by the U.K. CFC in the United Kingdom for U.K. income tax purposes. In addition, income derived by the French QBU from transactions with customers in France is eligible for the exceptions if substantially all of the activities in connection with the transactions are performed in France by employees of the French QBU, and the income is treated as earned by the French QBU in France for French income tax purposes.

Income from cross border transactions.—If the requirements above are satisfied, the exceptions also apply to income from certain cross border transactions, but only if a higher standard with respect to the substantial activity requirement is satisfied. Under the bill, income derived by a CFC from transactions with customers not located in the CFC's home country or the United States is eligible for the exceptions if the CFC conducts substantial activity with respect to a banking, financing, or similar business in its home country. In addition, income derived by a QBU of an eligible CFC from transactions with customers not located in the QBU's home country or the United States is eligible for the exceptions, but only if the QBU conducts substantial activity with respect to such a business in its home country. For this purpose, the substantial activity requirement is applied by looking only at the activities of the applicable CFC or QBU on a stand-alone basis. Thus, income derived by a QBU from transactions with customers not located in its home country (or in the United States) is eligible for the exceptions if the activities of the QBU itself constitute substantial activities (provided that the other requirements are satisfied).

Consider again the U.K. CFC and the French QBU. If the head office of the U.K. CFC derives income from a transaction with a customer in Germany, the income is eligible for the exceptions if the activities of the CFC itself (without regard to those of the French QBU) satisfy the substantial activity requirement. Alternatively, if the French QBU derives income from a transaction with a German customer, the income is eligible for the exceptions if the activities of the French QBU itself satisfy the substantial activity requirement.

Home country requirement for income earned with respect to a lending or finance business.—In the case of a lending or finance business, in addition to the requirements described above, the bill includes an additional requirement to qualify for the exceptions in the case of income earned by a CFC that is an eligible CFC which satisfies the predominantly engaged requirement for an active lending or finance business. For such an eligible CFC, income derived by such CFC is eligible for the exceptions only if such CFC derives more than 30 percent of its gross income directly from the active and regular conduct of a lending or finance business from transactions with customers that are unrelated persons and that are located within the CFC's home country (the "home country" requirement). In addition, income derived by a QBU of such an eligible CFC is eligible for the exceptions only if such QBU derives more than 30 percent of its gross income directly from the active and regular conduct of a lending or finance business from transactions with customers that are unrelated persons and that are located within the QBU's home country. For this purpose, it is intended that transactions with customers located in the United States not be taken into account.

The home country requirement is applied on a stand-alone basis to the particular CFC or QBU. Thus, the 30-percent gross income test takes into account only the gross income of a particular CFC (without regard to the income of its QBUs) from transactions with its home-country unrelated customers. Similarly, in the case of a QBU, there is taken into account the gross income of the particular QBU (without regard to the income of the CFC or other QBUs) from transactions with its home country unrelated customers. Accordingly, if more than 70 percent of the CFC's gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with unrelated customers, and one of the CFC's QBUs satisfies the home country requirement but another QBU does not satisfy such requirement, income derived by the QBU that satisfies the home country requirement is eligible for the exceptions from subpart F (provided that the other requirements are satisfied), but income derived by the other QBU is not eligible for the exceptions.

Coordination with dealer exception.—The bill provides that the exceptions under section 954(h) for income derived in the active conduct of a banking, financing, or similar business do not apply to income described in the dealer exception under section 954(c)(2)(C)(ii) (described below) for a dealer in securities which is an eligible CFC that satisfies the predominantly engaged requirement for a securities business.

Exception for securities dealers

The bill provides an additional exception from foreign personal holding company income for certain income derived by a securities dealer within the meaning of section 475 (the so-called "dealer exception"). The dealer exception applies to interest or dividends (or equivalent amounts described in sec. 954(c)(1)(E) or (G)) from any transaction (including a hedging transaction or a transaction consisting of a deposit of collateral or margin described in sec. 956(c)(2)(J)) entered into in the ordinary course of the dealer's trade or business as such a securities dealer, but only if the income is attributable to activities of the dealer in the country in which the dealer is created or organized (or, in the case of a QBU of the dealer, is attributable to activities of the QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity). For this purpose, income is considered to be attributable to activities of the dealer in its country of incorporation (or to a QBU in the country in which the QBU both maintains its principal office and conducts substantial business activity), if such income is attributable to activities performed in such country by employees of the dealer (or QBU), and such income is treated as earned in such country by the dealer (or QBU) for purposes of such country's tax laws. For this purpose, income is considered to be earned in the country in which the dealer is created or organized (or, in the case of a QBU, in the country in which the QBU both maintains its principal office and conducts substantial business activity), if such income is sourced and allocable to such dealer (or QBU) in such country for purposes of such country's tax laws. It is intended that the dealer exception not apply to income from transactions with persons located in the United States with respect to U.S. securities. In addition, it is intended that the dealer exception will apply to interest paid by customers to the dealer on margin loans in connection with sales of securities (provided that the other requirements of the provision are satisfied).

Insurance income

In general

The bill provides a temporary exception to insurance income under section 953. For purposes of the exception to insurance income, reserves for an exempt insurance or annuity contract are determined in the same manner as under the temporary exception, described below, for foreign personal holding company income relating to certain insurance contracts (sec. 954(i), as added by the bill). For purposes of these provisions, reserves are intended to include discounted unpaid losses or losses incurred, as appropriate, for property and casualty contracts.

Operation of the exception

The bill provides an exception from insurance income for income derived by a qualifying insurance company that is attributable to the issuing (or reinsuring) of an exempt contract by the qualifying insurance company or a qualifying insurance company branch of such a company, and that is treated as earned by the company or branch in that company's, or branch's, home country for purposes of that country's tax laws. The exception from insurance income does not apply to income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring a contract that is not an exempt contract). An exempt contract is an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualified insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.

No contract is treated as an exempt contract unless the qualifying insurance company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this sentence) covering applicable home country risks, and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (within the meaning of sec. 954(d)(3)). Applicable home country risks are risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or branch, as the case may be. In all cases, the 30 percent test is applied on a unit-by-unit basis. Accordingly, income derived by a qualifying insurance company branch of a CFC qualifies only if such branch alone satisfies the 30 percent test (without regard to the net written premiums of any other branch). Income derived by the CFC qualifies only if the CFC alone satisfies the 30 percent test without regard to the net written premiums of any other unit or branch of the CFC.

When determinations under the bill are made separately with respect to a qualifying insurance company and its qualifying insurance company branch or branches, then in the case of the qualifying insurance company, only income, gain, or loss and activities of the company not properly allocable or attributable to any qualifying insurance company branch are taken into account. In the case of a qualifying insurance company branch, only income, gain, or loss and activities of the branch that are properly allocable or attributable to it are taken into account. Under the bill, the Secretary is granted the authority to carry out the purposes of these exceptions. It is intended that such authority includes the authority to prescribe rules for properly allocating items and activities among branches or units of a CFC, and among the CFC and its branches or units.

The home country of a CFC is the country in which the CFC is created or organized. The home country of a qualified business unit that is a qualifying insurance company branch of a qualifying insurance company means the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance or annuity contracts to persons other than related persons (within the meaning of sec. 954(d)(3)) in that country.

Qualifying insurance company

A qualifying insurance company is a CFC that meets the following requirements, which are intended to distinguish firms that have a real business nexus with a foreign country or countries from firms that do not. The first requirement is that the CFC be subject to regulation as an insurance (or reinsurance) company by its home country, and that the CFC be licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in its home country.

The second requirement is that the CFC derive more than 50 percent of its aggregate net written premiums from the insurance or reinsurance by the CFC (on an aggregate basis, including qualifying insurance company branches) covering applicable home country risks (as described above) of the CFC or branch, as the case may be. For purposes of this rule, if a policyholder, insured, annuitant, or beneficiary is a related person, then the contract is treated as not covering home country risks. A related person has the meaning set forth in section 954(d)(3). In the case of a qualifying insurance company branch, premiums are taken into account under this second requirement only to the extent the premiums are treated as earned by the branch in its home country for purposes of that country's tax laws.

The 50 percent test applies on an aggregate basis. For example, assume that a German CFC has a branch in France and a branch in Italy. Assume that $50 of net written premiums are properly allocable to the Italian branch, $100 of net written premiums are properly allocable to the French branch, and $100 of net written premiums are properly allocable to the CFC in Germany. For the Italian branch, assume $20 of the $50, or 40 percent, is from home country risks. For the French branch, assume that $80 of the $100, or 80 percent, is from home country risks. For the CFC in Germany, assume that $60 of the $100, or 60 percent, is from home country risks. Taking into account the respective amounts and percentages, the CFC has 64 percent of its net written premiums from home country risks on an aggregate basis.

The third requirement is that the CFC be engaged in the insurance business and that it would be subject to tax under subchapter L if it were a domestic corporation. A CFC is considered to be engaged in the insurance business, within the meaning of this bill, if it operates in a manner consistent with the operation of other bona fide commercial insurance companies that sell insurance products to unrelated parties in its home country, and conducts managerial activities in that country with respect to the major functions of the insurance business. A factor, among others, that could be considered in determining whether it conducts managerial activities in its home country with respect to the major functions of the insurance business may be whether in its home country it exercises key decision making in determining business strategy with respect to the major functions of the insurance business. For purposes of the requirement that the CFC be engaged in the insurance business, activities performed in the home country of the CFC by employees of the CFC and of a related person are taken into account, to the extent that the related person is compensated on a arm's length basis for the services of such employees and such compensation is includible in the related person's income in such country for purposes of that country's tax laws. For this purpose, a related person has the meaning provided in section 954(d)(3), substituting "at least 80 percent" for "more than 50 percent." In determining whether a CFC is engaged in the insurance business, for example, an entity that is not engaged in regular and continuous transactions with persons that are not related persons (as described in the generally applicable anti-abuse rules) is not considered as engaged in the insurance business.

Qualifying insurance company branch

A qualifying insurance company branch is a qualified business unit of a CFC that meets two requirements. A qualified business unit means any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records (within the meaning of sec. 989(a)). The first requirement is that the unit be licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance or annuity contracts to persons other than related persons (within the meaning of sec. 954(d)(3)) in that country. It is intended that the applicable insurance regulatory body be the regulatory body that has the authority to license, authorize, or regulate with respect to the insurance business in the country where the branch is located and a branch that is regulated by such a body be considered to be regulated in the country where the branch is located. The second requirement is that the CFC (of which the branch is a unit) be a qualifying insurance company, taking the unit into account for purposes of the applicable tests (above) as if it were a qualifying insurance company branch.

Additional requirements in the case of cross border risks

The bill imposes additional requirements with respect to any contract that covers cross border risks (that is, risks other than applicable home country risks), due to the increased concern about mobility of income in cross border business. A contract issued by a qualifying insurance company or qualifying insurance company branch that covers risks other than applicable home country risks is not treated as an exempt contract unless such company or branch, as the case may be, (1) conducts substantial activity in its home country with respect to the insurance business, and (2) performs in its home country substantially all of the activities necessary to give rise to the income generated by the contract.

Whether a CFC or unit thereof is considered to perform in its home country substantial activities with respect to the insurance business is determined under all the facts and circumstances. It is intended that as part of this facts and circumstances analysis in determining whether the activities conducted by the CFC or unit are substantial, all relevant factors are taken into account, including the overall size of the CFC or unit, the amount of its revenues and expenses, the number of its employees, the ratio of its revenues per employee, the amount of property it owns, and the nature, size and relative significance of the applicable activities conducted by the CFC or unit. Under the bill, the Secretary is granted the authority to carry out the purposes of these exceptions. It is intended that such authority includes the authority to prescribe regulations relating to whether a CFC or unit is considered to conduct substantial activity.

It also is intended that as part of this facts and circumstances analysis, a CFC or unit is required to conduct substantially all of the activities necessary for the generation of income with respect to the insurance business. Such activities of an insurance business generally depend on the line of business, and could include:

Designing or tailoring insurance products to meet market or customer requirements;

Performing actuarial analysis with respect to insurance products;

Determining investment options for separate account-type products;

Performing underwriting functions with respect to insurance products;

Performing analysis for purposes of risk assessment;

Performing analysis for purposes of setting premium rates;

Performing analysis for purposes of calculating reserves;

Performing claims management and adjustment functions;

Developing marketing strategies, advertising and other public image activities;

Making (or arranging for) sales to customers;

Maintaining reserves and surplus (other than excess surplus);

Making (or arranging for) investments; and

Collecting from customers.

It further is intended that the performance of back-office functions (including accounting for income or loss, recordkeeping, and routine communicating with customers) not be taken into account in determining whether the substantial activity requirement is satisfied. It also is intended that the relevant activities of the business may be modified by Treasury regulation to take into account the actual operation of lines of insurance business and future changes in the operation of lines of insurance business.

It further is intended that activities performed in the CFC's or unit's home country by employees of a related person (within the meaning of sec. 954(d)(3), substituting "at least 80 percent" for "more than 50 percent") be taken into account, to the extent that the related person is compensated on an arm's length basis for the services of such employees and such compensation is includible in the related person's income in that country for purposes of such country's tax laws. It also is intended that the activities of such a related person are not again taken into account in determining whether another CFC or unit (e.g., the related person) satisfies the substantial activity requirement.

In addition, with respect to a contract issued by a qualifying insurance company or qualifying insurance company branch that covers risks other than applicable home country risks, the qualifying insurance company or qualifying insurance company branch is required to perform in its home country substantially all of the activities necessary to give rise to the income generated by the contract.

Foreign personal holding company income with respect to insurance

The bill provides a temporary exception from foreign personal holding income for certain investment income derived by a qualifying insurance company and by certain qualifying insurance company branches.

The exception applies to income (received from a person other than a related person) from investments made by a qualifying insurance company or qualifying insurance company branch of its reserves allocable to exempt contracts or 80 percent of its unearned premiums from exempt contracts. For this purpose, an exempt contract has the meaning provided under the bill.

In the case of exempt contracts that are 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 are used if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L of the Code, with certain modifications. For this purpose, unearned premiums and losses incurred are determined in accordance with section 832(b) 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). However, in applying these rules, there is substituted for the applicable Federal interest rate the interest rate determined for the functional currency of the company or branch and which (except as provided by the Treasury Secretary) is calculated in the same manner as the Federal mid-term rate under section 1274(d). In addition, there is substituted for the loss payment pattern under section 846 the appropriate foreign loss payment pattern determined by the Treasury Secretary for the line of business. In the case of health insurance contracts, it is intended that appropriate foreign mortality and morbidity tables be used for this purpose.

In the case of an exempt contract that is a life insurance or annuity contract, reserves for such contracts are determined as follows. The reserves equal the greater of: (1) the net surrender value of the contract (as defined in section 807(e)(1)(A)), including in the case of pension plan contracts; or (2) the amount determined by applying the tax reserve method that would apply if the qualifying insurance company were subject to tax under Subchapter L of the Code, with the following modifications. First, there is substituted for the applicable Federal interest rate an interest rate determined for the functional currency of the qualifying insurance company's home country, calculated (except as provided by the Treasury Secretary in order to address insufficient data and similar problems) in the same manner as the mid-term applicable Federal interest rate ("AFR") (within the meaning of section 1274(d)). Second, there is substituted for the prevailing State assumed rate the highest assumed interest rate permitted to be used for purposes of determining statement reserves in the foreign country for the contract. Third, in lieu of U.S. mortality and morbidity tables, there are applied mortality and morbidity tables that reasonably reflect the current mortality and morbidity risks in the foreign country. Fourth, the Treasury Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for one or more of its branches when appropriate.

In no event may the reserve for any contract at any time exceed the foreign statement reserve for the contract, reduced by any catastrophe, equalization, or deficiency reserve or any similar reserve. In the case of a contract that is a property, casualty, or health insurance contract, it is intended that this limitation applies with respect to unpaid losses by line of business (similar to sec. 846(a)(3)). These rules apply whether the contract is regulated as a property, casualty, health, life insurance, annuity, or any other type of contract.

The bill also provides an exception from foreign personal holding company income for income from investment of assets equal to (1) one-third of premiums earned during the taxable year on exempt contracts regulated in the country in which sold as property, casualty, or health insurance contracts, and (2) 10 percent of reserves (determined for purposes of the bill) for contracts regulated in the country in which sold as life insurance or annuity contracts. In no event does the exception from foreign personal holding company income apply to investment income with respect to excess surplus.

To prevent the shifting of relatively high-yielding assets to generate investment income that qualifies under this temporary exception, the bill provides that, except as provided by the Treasury Secretary, income is allocated to contracts as follows. In the case of a separate account-type contract (including a variable contract not meeting the requirements of section 817), the income credited under the contract is allocable only to that contract. Income not so allocated generally is allocated ratably among all contracts that are not separate account-type contracts, subject to the anti-abuse rules (described below).

Other definitions and anti-abuse rules relating to insurance

The bill provides that the present-law statutory definition of a life insurance contract (under secs. 7702 or 101(f)), as well as the distribution on death requirement of section 72(s) and the diversification requirement of section 817(h), do not apply for purposes of determining reserves for a life insurance or annuity contract under sections 953 and 954 of the Code, provided that neither the policyholders, the insureds or annuitants, nor the beneficiaries with respect to the contract are U.S. persons.

The bill provides a rule coordinating the exception to insurance income with the present-law special rule for certain captive insurance companies (sec. 953(c)). Under the coordination rule, the scope of the present-law rule that related party insurance income is treated as subpart F income is retained. The exception under the bill from the definition of insurance income does not include income derived from exempt contracts that cover risks other than applicable home country risks, for purposes of the rules of section 953(c).

The anti-abuse rules applicable under the subpart F exceptions provided in section 954(h) (other than sec. 954(h)(7)(B)) (as added by the bill) apply to these exceptions for insurance. In addition, the bill provides anti-abuse rules applicable under the exceptions from subpart F income relating to insurance.

The bill provides that there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons that are not related persons. This rule is intended, for example, to address the use of fronting companies or similar entities (that are not engaged in regular and continuous transactions with persons that are not related persons) to reinsure risks in a manner to cause a CFC or branch to qualify as a qualifying insurance company or qualifying insurance company branch by meeting percentage requirements with respect to home country risks that it would not otherwise meet.

The bill provides that there shall be disregarded 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 bill also provides that a contract is not treated as an exempt contract (as described above), if any policyholder, insured or annuitant, or beneficiary is a resident of the United States, the contract was marketed to the U.S. resident, and was written to cover a risk outside the United States.

The bill also provides that a contract is not treated as an exempt contract, if the contract covers risks located both within and outside the United States, and the qualifying insurance company or branch does not maintain such records, and file such reports, with respect to the contract as the Treasury Secretary requires. It is intended that documentation that is contemporaneous with the issuance of the contract be maintained by the qualifying insurance company or branch.

The bill also provides that the Treasury Secretary may prescribe rules for the allocation of contracts (and income from contracts) among two or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches.

The bill also provides that premiums from a contract are treated as not covering home country risks (and are treated as covering risks other than home country risks) for purposes of the tests for 30 percent and 50 percent, respectively, of net written premiums if the contract reinsures a contract issued or reinsured by a related person (within the meaning of sec. 954(d)(3)).

The bill also provides that the Treasury Secretary may prescribe regulations as may be necessary or appropriate to carry out the purposes of the exceptions from insurance income and foreign personal holding company income provided under sections 953(e) and 954(i) (as added by the bill).

Other anti-abuse rules

The bill generally includes the anti-abuse rules of the present-law provision, with certain further refinements. Under the bill, the anti-abuse rules provide that items with respect to a transaction or series of transactions are disregarded if one of the principal purposes of the transaction or transactions is to qualify income or gain for these exceptions, including any transaction or a series of transactions a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of these exceptions. In addition, the anti-abuse rules provide that items of an entity which is not engaged in regular and continuous transactions with customers which are not related persons are disregarded. Moreover, items with respect to a transaction or series of transactions are disregarded if one of the principal purposes of the transaction or transactions is to qualify income or gain for these exceptions, including utilizing or doing business with: (1) one or more entities in order to satisfy any home country requirement, or (2) a special purpose entity or arrangement, including a securitization or financing arrangement or any similar entity or arrangement. Finally, the anti-abuse rules provide that a related person, officer, director, or employee with respect to any CFC (or QBU) which otherwise would be treated as a customer of such corporation or unit with respect to any transaction would not be treated as a customer, if a principal purpose of such transaction is to satisfy any requirement for these exceptions.

Sale of assets of an active financing business

The bill includes a modification to address the treatment of sales of assets of an active financing business. In general, foreign personal holding company income includes net gains from the sale or exchange of property that gives rise to dividends, interest, royalties, rents, or annuities. The bill provides an exception from this rule for income that qualifies for the exception from subpart F for income derived in the active conduct of a banking, financing, or similar business. Under the bill, foreign personal holding company income does not include net gains from the sale or exchange of property that gives rise to dividends, interest, royalties, rents, or annuities if such property gives rise to income not treated as foreign personal holding company income for the taxable year by reason of the exceptions under section 954(h) or (i) (as added by the bill) for income derived in the active conduct of a banking, financing, or similar business or in the conduct of an insurance business. It is intended that this exception applies only to the extent that, prior to its disposition, the property was held to generate or generated income which qualifies for the exceptions under section 954(h) or (i) (and such property was not so held for a principal purpose of taking advantage of this exception).

Exceptions from foreign base company services income

The present-law provision includes a corresponding exception from foreign base company services income for income derived by a CFC from the performance of services that are directly related to a transaction entered into by the CFC that gives rise to income that is eligible for these exceptions from subpart F. Under the bill, foreign base company services income does not include income that is not treated as foreign personal holding company income by reason of the exceptions under section 954(h) or 954(i) or the securities dealer exception under section 954(c)(2)(C)(ii), or treated as exempt insurance income by reason of section 953(e) (as added by the bill).

EFFECTIVE DATE

The provision applies only to taxable years of foreign corporations beginning in 1999, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.

F. Extension of the Generalized System of Preferences (sec. 311 of the bill and sec. 505 of the Trade Act of 1974)

PRESENT AND PRIOR LAW

Title V of the Trade Act of 1974, as amended, grants authority to the President to provide duty-free treatment on imports of certain articles from beneficiary developing countries subject to certain conditions and limitations. To qualify for GSP privileges, each beneficiary country is subject to various mandatory and discretionary eligiblity criteria. Import sensitive products are ineligible for GSP. The GSP program, which is designed to promote development through trade rather than traditional aid programs, expired after June 30, 1998.

REASONS FOR CHANGE

The Committee believes it is appropriate to extend the GSP program.

EXPLANATION OF PROVISION

The bill reauthorizes the GSP program to terminate after February 29, 2000. Refunds would be authorized, upon request of the importer, for duties paid between July 1, 1998, and the date of enactment of the bill.

EFFECTIVE DATE

The provision is effective for duties paid on or after July 1, 1998, and before March 1, 2000.

TITLE IV. REVENUE OFFSET PROVISION

A. Treatment of Certain Deductible Liquidating Distributions of Regulated Investment Companies and Real Estate Investment Trusts (sec. 401 of the bill and secs. 332 and 334 of the Code)

PRESENT LAW

Regulated investment companies ("RICs") and real estate investment trusts ("REITs") are allowed a deduction for dividends paid to their shareholders. The deduction for dividends paid includes amounts distributed in liquidation which are properly chargeable to earnings and profits, as well as, in the case of a complete liquidation occurring within 24 months after the adoption of a plan of complete liquidation, any distribution made pursuant to such plan to the extent of earnings and profits. Rules that govern the receipt of dividends from RICs and REITs generally provide for including the amount of the dividend in the income of the shareholder receiving the dividend that was deducted by the RIC or REIT. Generally, any shareholder realizing gain from a liquidating distribution of a RIC or REIT includes the amount of gain in the shareholder's income. However, in the case of a liquidating distribution to a corporation owning 80-percent of the stock of the distributing corporation, a separate rule generally provides that the distribution is tax-free to the parent corporation. The parent corporation succeeds to the tax attributes, including the adjusted basis of assets, of the distributing corporation. Under these rules, a liquidating RIC or REIT might be allowed a deduction for amounts paid to its parent corporation, without a corresponding inclusion in the income of the parent corporation, resulting in income being subject to no tax.

A RIC or REIT may designate a portion of a dividend as a capital gain dividend to the extent the RIC or REIT itself has a net capital gain, and a RIC may designate a portion of the dividend paid to a corporate shareholder as eligible for the 70-percent dividends-received deduction to the extent the RIC itself received dividends from other corporations. If certain conditions are satisfied, a RIC also is permitted to pass through to its shareholders the tax-exempt character of the RIC's net income from tax-exempt obligations through the payment of "exempt interest dividends," though no deduction is allowed for such dividends.

REASONS FOR CHANGE

RICs and REITs are important investment vehicles, particularly for small investors. The RIC and REIT rules are designed to encourage investors to pool their resources and achieve the type of investment opportunities, subject to a single level of tax, that otherwise would be available only to a larger investor. Nonetheless, the Committee understands that some corporations have attempted to use the "dividends paid deduction" for a RIC or REIT in combination with the separate rule that allows a corporate parent to receive property from an 80 percent subsidiary without tax when the subsidiary is liquidating, and have argued that the combination of these two rules permits income deducted by the RIC or REIT and paid to the parent corporation to be entirely tax free during the period of liquidation of the RIC or REIT. The Committee believes that income of a RIC or REIT which is not taxable to the RIC or REIT because of the dividends paid deduction also should not be excluded from the income of the RIC's or REIT's shareholders as a liquidating distribution to a parent shareholder. This legislation will not affect the intended beneficiaries of the RIC and REIT rules.

EXPLANATION OF PROVISION

Any amount which a liquidating RIC or REIT may take as a deduction for dividends paid with respect to an otherwise tax-free liquidating distribution to an 80-percent corporate owner is includible in the income of the recipient corporation. The includible amount is treated as a dividend received from the RIC or REIT. The liquidating corporation may designate the amount treated as a dividend as a capital gain dividend or, in the case of a RIC, a dividend eligible for the 70-percent dividends received deduction or an exempt interest dividend, to the extent provided by the RIC or REIT provisions of the Code.

The provision does not otherwise change the tax treatment of the distribution to the parent corporation or to the RIC or REIT. Thus, for example, the liquidating corporation will not recognize gain (if any) on the liquidating distribution and the recipient corporation will hold the assets at a carryover basis, even where the amount received is treated as a dividend..

EFFECTIVE DATE

The provision is effective for distributions on or after May 22, 1998, regardless of when the plan of liquidation was adopted.

No inference is intended regarding the treatment of such transactions under present law.

TITLE V. TAX TECHNICAL CORRECTIONS

Except as otherwise provided, the technical corrections contained in the bill generally are effective as if included in the originally enacted related legislation.

A. Technical Corrections to the 1998 Act

1. Burden of proof (sec. 502(b) of the bill, sec. 3001 of the 1998 Act, and sec. 7491 (a)(2)(C) of the Code)

PRESENT LAW

The Treasury Secretary has the burden of proof in any court proceeding with respect to a factual issue if the taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the taxpayer's tax liability, provided specified conditions are satisfied (sec. 7491). One of these is that corporations, trusts, and partnerships must meet certain net worth limitations. These net worth limitations do not apply to individuals or to estates.

EXPLANATION OF PROVISION

The provision removes the net worth limitation from certain revocable trusts for the same period of time that the trust would have been treated as part of the estate had the trust made the election under section 645 to be treated as part of the estate.

2. Relief for innocent spouses (sec. 502(c) of the bill, sec. 3201 of the 1998 Act, and secs. 2024(a) and 6015(e) of the Code)

PRESENT LAW

A taxpayer who is no longer married to, is separated from, or has been living apart for at least 12 months from the person with whom he or she originally joined in filing a joint Federal income tax return may elect to limit his or her liability for a deficiency arising from such joint return to the amount of the deficiency that is attributable to items that are allocable to such electing spouse. The election is limited to deficiency situations and only affects the amount of the deficiency for which the electing spouse is liable. Thus, the election cannot be used to generate a refund, to direct a refund to one spouse or the other, or to allocate responsibility for payment where a balance due is reported on, but not paid with, a joint return.

In addition to the election to limit the liability for deficiencies, a taxpayer may be eligible for innocent spouse relief. Innocent spouse relief allows certain taxpayers who joined in the filing of a joint return to be relieved of liability for an understatement of tax that is attributable to items of the other spouse to the extent that the taxpayer did not know or have reason to know of the understatement. The Secretary is also authorized to provide equitable relief in situations where, taking into account all of the facts and circumstances, it is inequitable to hold an individual responsible for all or a part of any unpaid tax or deficiency arising from a joint return. Under certain circumstances, it is possible that a refund could be obtained under this authority.

EXPLANATION OF PROVISION

The provision clarifies that the ability to obtain a credit or refund of Federal income tax is limited to situations where the taxpayer qualifies for innocent spouse relief or where the Secretary exercises his authority to provide equitable relief.

3. Interest netting (sec. 502(d) of the bill and sec. 3301 (c)(2) of the 1998 Act)

PRESENT LAW

For calendar quarters beginning after July 22, 1998, a net interest rate of zero applies where interest is payable and allowable on equivalent amounts of overpayment and underpayment of any tax imposed by the Internal Revenue Code. In addition, the net interest rate of zero applies to periods on or before July 22, 1998, providing (1) the statute of limitations has not expired with respect to either the underpayment or overpayment, (2) the taxpayer identifies the periods of underpayment and overpayment where interest is payable and allowable for which the net interest rate of zero would apply, and (3) on or before December 31, 1999, the taxpayer asks the Secretary to apply the net zero rate.

EXPLANATION OF PROVISION

The provision restores language originally included in the Senate amendment that clarifies that the applicability of the zero net interest rate for periods on or before July 22, 1998 is subject to any applicable statute of limitations not having expired with regard to either a tax underpayment or overpayment.

4. Effective date for elimination of 18-month holding period for capital gains (sec. 502(h) of the bill, sec. 5001 of the 1998 Act, and sec. 1(h) of the Code)

PRESENT LAW

The 1998 Act repealed the provision in the 1997 Act providing a maximum 28-percent rate for the long-term capital gain attributable to property held more than one year but not more than 18 months. Instead, the 1998 Act treated this gain in the same manner as gain from property held more than 18 months. The provision in the 1998 Act is effective for amounts properly taken into account after December 31, 1997. For gains taken into account by a pass-thru entity, such as a partnership, S corporation, trust, estate, RIC or REIT, the date that the entity properly took the gain into account is the appropriate date in applying this provision. Thus, for example, amounts properly taken into account by a pass-thru entity in 1997 with respect to property held more than one year but not more than 18 months which are included in income on an individual's 1998 return are taken into account in computing 28-percent rate gain.

EXPLANATION OF PROVISION

Under the provision, in the case of a capital gain dividend made by a RIC or REIT after 1997, no amount will be taken into account in computing the net gain or loss in the 28-percent rate gain category by reason of property being held more than one year but not more than 18 months, other than amounts taken into account by the RIC or REIT from other pass-thru entities (other than in structures, such as a "master-feeder structure", in which the RIC invests a substantial portion of its assets in one or more partnerships holding portfolio securities and having the same taxable year as the RIC). A similar rule applies to amounts properly taken into account by a RIC or REIT by reason of holding, directly or indirectly, an interest in another RIC or REIT to which the rule in the preceding sentence applies.

For example, if a RIC sold stock held more than one year but not more than 18 months on November 15, 1997, for a gain, and makes a capital gain dividend in 1998, the gain is not taken into account in computing 28-percent rate gain for purposes of determining the taxation of the 1998 dividend. (Thus, all the netting and computations made by the RIC need to be redone with respect to all post-1997 capital gain dividends, whether or not dividends of 28-percent rate gain.) If, however, the gain was taken into account by a RIC by reason of holding an interest in a calendar year 1997 partnership which itself sold the stock, the gain will not be recharacterized by reason of this provision (unless the RIC's investment in the partnership satisfies the exception for master-feeder structures). If the gain was taken into account by a RIC by reason on holding an interest in a REIT and the gain was excluded from 28-percent rate gain by reason of the application of this provision to the REIT, the gain will be excluded from 28-percent rate gain in determining the tax of the RIC shareholders.

The provision also corrects a cross reference.

B. Technical Corrections to the 1997 Act

1. Treatment of interest on qualified education loans (sec. 503(a) of the bill, sec. 202 of the 1997 Act, and secs. 221 and 163(h) of the Code)

PRESENT LAW

Present law, as modified by the 1997 Act, provides that certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expense, up to a maximum dollar amount per year ($1,000 for taxable years beginning in 1998), subject to certain requirements. Present law also provides that in the case of a taxpayer other than a corporation, no deduction is allowed for personal interest. For this purpose, personal interest means any interest allowable as a deduction, other than certain types of interest listed in the statute. This provision does not specifically provide that otherwise deductible qualified education loan interest is not treated as personal interest.

EXPLANATION OF PROVISION

The provision clarifies that otherwise deductible qualified education loan interest is not treated as nondeductible personal interest.

2. Capital gain distributions of charitable remainder trusts (sec. 503(b) of the bill, sec. 311 of the 1997 Act and sec. 5001 of the 1998 Act, and sec. 1(h) of the Code)

PRESENT LAW

Under present law, the income beneficiary of a charitable remainder trust ("CRT") includes the trust's capital gain in income when the gains are distributed to the beneficiary (sec. 664(b)(2)). Internal Revenue Service Notice 98–20 provides guidance with respect to the categorization of long-term capital gain distributions from a CRT under the capital gain rules enacted by the 1997 Act. Under the Notice, long-term capital gains properly taken into account by the trust before January 1, 1997, are treated as falling in the 20-percent group of gain (i.e., gain not in the 28-percent rate gain or unrecaptured sec. 1250 gain). Long-term capital gains properly taken into account by the trust after December 31, 1996, and before May 7, 1997, are included in 28-percent rate gain. Long-term capital gains properly taken into account by the trust after May 6, 1997, are treated as falling into the category which would apply if the trust itself were subject to tax.

EXPLANATION OF PROVISION

The provision provides that, in the case of a capital gain distribution by a CRT after December 31, 1997, with respect to amounts properly taken into account by the trust during 1997, amounts will not be included in the 28-percent rate gain category solely by reason of being properly taken into account by the trust before May 7, 1997, or by reason of the property being held not more than 18 months. Thus, for example, the sale of stock by a CRT on February 1, 1997, will not be taken into account in determining 28-percent rate gain where the gain is distributed after 1997.

EFFECTIVE DATE

The provision applies to taxable years beginning after December 31, 1997.

3. Gifts may not be revalued for estate tax purposes after expiration of statute of limitations (sec. 503(c) of the bill, sec. 506 of the 1997 Act, and secs. 2001(f)(2) and 6501(c)(9) of the Code)

PRESENT LAW

Basic structure of Federal estate and gift taxes.—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 in that year and in 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, the unified credit, and certain other credits.

This structure raises two different, but related, issues: (1) what is the period beyond which additional gift taxes cannot be assessed or collected—generically referred to as the "statute of limitations"—and (2) what is the period beyond which the amount of prior transfers cannot be revalued for the purpose of determining the amount of tax on subsequent transfers.

Gift tax statute of limitations.—Section 6501(a) provides the general rule that any tax (including gift and estate tax) must be assessed within three years after the return is filed by the taxpayer. Under section 6501(e)(2), the period for assessments of gift or estate tax is increased to six years where there is more than a 25 percent omission in the amount of the total gifts or gross estate disclosed on the gift or estate tax return.

Revaluation of gifts for gift tax purposes.—Under a 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 if the statute of limitations for assessment of gift tax on the prior gifts has expired.

In addition, section 6501(c)(9) provides that the value of any item which is required to be disclosed on a gift tax return may not be redetermined by the Commissioner after the expiration of the statute of limitations. 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). Further, 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). The IRS is to develop an administrative appeals process whereby a taxpayer can challenge a redetermination of value by the IRS prior to issuance of a final notice. In the event the taxpayer and the IRS cannot agree on the value of a gift, the 1997 Act provided the U.S. Tax Court with jurisdiction to issue a declaratory judgment on the value of a gift (section 7477). 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 U.S. 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.

Revaluation of gifts for estate tax purposes.—Similarly, a gift cannot be revalued for purposes of determining the applicable estate tax bracket and available unified credit if (1) the statute of limitations has expired and (2) the value of the gift is shown or disclosed on gift tax return or is disclosed in a statement attached to the gift tax return (section 2001(f)).

EXPLANATION OF PROVISION

The bill clarifies the rules relating to revaluations of prior transfers for computation of the estate tax to provide that the value of a prior transfer cannot be redetermined if the transfer was disclosed on a gift tax return, or in a statement attached to the gift tax return, in a manner to adequately apprise the Treasury Secretary of the nature the transfer, even if there was no gift tax imposed on that transfer.

In addition, the bill removes the revaluation rule in section 6501(c)(9) since the substance of that rule also is provided in sections 2001(f) and 2504(c). The Committee intends that there be no change in the manner of finally determining the value of a gift as a result of this amendment.

4. Coordinate Vaccine Injury Compensation Trust Fund expenditure purposes with list of taxable vaccines (sec. 503(d) of the bill, sec. 904 of the 1997 Act, and sec. 9510(c) of the Code)

PRESENT LAW

A manufacturer's excise tax is imposed on certain vaccines routinely recommended for administration to children (sec. 4131). The tax is imposed at a rate of $0.75 per dose on any listed vaccine component. Taxable vaccine components are vaccines against diphtheria, tetanus, pertussis, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, and varicella (chicken pox). Tax was imposed on vaccines against diphtheria, tetanus, pertussis, measles, mumps, rubella, and polio by the Omnibus Budget Reconciliation Act of 1987. Tax was imposed on vaccines against HIB, hepatitis B, and varicella by the 1997 Act.

Amounts equal to net revenues from this excise tax are deposited in the Vaccine Injury Compensation Trust Fund ("Vaccine 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. Present law provides that payments from the Vaccine Trust Fund may be made only for vaccines eligible under the program as of December 22, 1987 (sec. 9510(c)(1)). Thus, payments may not be made for injuries related to the HIB, hepatitis B or varicella vaccines.

EXPLANATION OF PROVISION

The provision provides that payments are permitted from the Vaccine Trust Fund for injuries related to the administration of the HIB, hepatitis B, and varicella vaccines. The provision also clarifies that expenditures from the Vaccine Trust Fund may occur only as provided in the Code and makes conforming amendments.

5. Abatement of interest by reason of Presidentially declared disasters (sec. 503(e) of the bill, sec. 915 of the 1997 Act, and sec. 6404(h) of the Code)

PRESENT LAW

The Taxpayer Relief Act of 1997 ("1997 Act") provided that, if the Secretary of the Treasury extends the filing date of an individual tax return for 1997 for individuals living in an area that has been declared a disaster area by the President during 1997, no interest shall be charged as a result of the failure of an individual taxpayer to file an individual tax return, or pay the taxes shown on such return, during the extension.

The Internal Revenue Service Restructuring and Reform Act of 1998 ("1998 Act") contains a similar rule applicable to all taxpayers for tax years beginning after 1997 for disasters declared after 1997. The status of disasters declared in 1998 but that relate to the 1997 tax year is unclear.

EXPLANATION OF PROVISION

The provision amends the 1997 Act rule so that it is available for disasters declared in 1997 or in 1998 with respect to the 1997 tax year.

6. Treatment of certain corporate distributions (sec. 503(f) of the bill, sec. 1012 of the 1997 Act, and secs. 351(c) and 368(a)(2)(H) of the Code)

PRESENT LAW

The 1997 Act (sec. 1012(a)) requires a distributing corporation to recognize corporate level gain on the distribution of stock of a controlled corporation under section 355 of the Code if, pursuant to a plan or series of related transactions, one or more persons acquire a 50-percent or greater interest (defined as 50 percent or more of the voting power or value of the stock) of either the distributing or controlled corporation (Code sec. 355(e)). Certain transactions are excepted from the definition of acquisition for this purpose. Under the technical corrections included in the Internal Revenue Service Restructuring and Reform Act of 1998, in the case of acquisitions under section 355(e)(3)(A)(iv), the acquisition of stock in the distributing corporation or any controlled corporation is disregarded to the extent that the percentage of stock owned directly or indirectly in such corporation by each person owning stock in such corporation immediately before the acquisition does not decrease.[1]

In the case of a 50-percent or more 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. No adjustment to the basis of the stock or assets of either corporation is allowed by reason of the recognition of the gain.[2]

The 1997 Act (as amended by the technical corrections contained in the Internal Revenue Service Restructuring and Reform Act of 1998) also modified 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,

[1] This exception (as certain other exceptions) does not apply if the stock held before the acquisition was acquired pursuant to a plan (or series of related transactions) to acquire a 50-percent or greater interest in the distributing or a controlled corporation.

[2] The 1997 Act does not limit the otherwise applicable Treasury regulatory authority under section 336(e) of the Code. Nor does it 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.

under section 351 and modified section 368(a)(2)(H) with respect to reorganizations under section 368(a)(1)(D), the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock shall not be taken into account.

The effective date (Act section 1012(d)(1)) states that the relevant provisions of the 1997 Act apply to distributions after April 16, 1997, pursuant to a plan (or series of related transactions) which involves an acquisition occurring after such date (unless certain transition provisions apply).

EXPLANATION OF PROVISION

The provision clarifies the "control immediately after" requirement of section 351(c) and section 368(a)(2)(H) in the case of certain divisive transactions in which a corporation contributes assets to a controlled corporation and then distributes the stock of the controlled corporation in a transaction that meets the requirements of section 355 (or so much of section 356 as relates to section 355). In such cases, not only the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock, but also the fact that the corporation whose stock was distributed issues additional stock, shall not be taken into account.

EFFECTIVE DATE

The provision generally is effective for distributions after April 16, 1997, as if included in the 1997 Act.

7. Treatment of net operating losses arising from certain eligible losses (sec. 503(g) of the bill, sec. 1082 of the 1997 Act, and sec. 172(b)(1)(F) of the Code)

PRESENT LAW

The 1997 Act changed the general net operating loss ("NOL") carryback period of a taxpayer from three years to two years. The three-year carryback period was retained in the case of an NOL attributable to an eligible loss. An eligible loss is defined as (1) a casualty or theft loss of an individual taxpayer, or (2) an NOL attributable to a Presidentially declared disaster area by a taxpayer engaged in a farming business or a small business. Other special rules apply to real estate investment trusts (REITs) (no carrybacks), specified liability losses (10-year carryback), and excess interest losses (no carrybacks).

EXPLANATION OF PROVISION

The provision coordinates the use of eligible losses with the general rule for NOLs in the same manner as a loss arising from a specified liability loss. Thus, an eligible loss for any year is treated as a separate net operating loss and is taken into account after the remaining portion of the net operating loss for the taxable year.

8. Determination of unborrowed policy cash value under COLI pro rata interest disallowance rules (sec. 503(h) of the bill, sec. 1084 of the 1997 Act, and sec. 264(f) of the Code)

PRESENT LAW

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 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. 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 unborrowed policy cash value of a contract.

EXPLANATION OF PROVISION

The provision clarifies the meaning of "unborrowed policy cash value" under section 264(f)(3), with respect to any life insurance, annuity or endowment contract. The technical correction clarifies that under section 264(f)(3), if the cash surrender value (determined without regard to any surrender charges) with respect to any policy or contract does not reasonably approximate its actual value, then the amount taken into account for this purpose is the greater of (1) the amount of the insurance company's liability with respect to the policy or contract, as determined for purposes of the annual statement approved by the National Association or Insurance Commissioners, (2) the amount of the insurance company's reserve with respect to the policy or contract for purposes of such annual statement; or such other amount as is determined by the Treasury Secretary. No inference is intended that such amounts may not be taken into account in determining the cash surrender value of a policy or contract in such circumstances for purposes of any other provision of the Code.

9. Payment of taxes by commercially acceptable means (sec. 503(i) of the bill, sec. 1205 of the 1997 Act, and sec. 6311 (d)(2) of the Code)

PRESENT LAW

The Code generally permits the payment of taxes by commercially acceptable means (such as credit cards) (sec. 6311(d)). The Treasury Secretary may not pay any fee or provide any other consideration in connection with this provision. This fee prohibition may have an unintended impact on Treasury contracts for the provision of services unrelated to the payment of income taxes by commercially acceptable means.

EXPLANATION OF PROVISION

The provision clarifies that the prohibition on paying any fees or providing any other consideration applies to the use of credit or debit cards for the payment of income taxes.

C. Technical Corrections to the 1984 Act

1. Casualty loss deduction (sec. 504 of the bill, sec. 711(c) of the 1984 Act, and secs. 172(d)(4), 67(b)(3), 68(c)(3), and 873(b) of the Code)

PRESENT LAW

The Tax Reform Act of 1984 ("1984 Act") deleted casualty and theft losses from property connected with a nonbusiness transaction entered into for profit from the list of losses set forth in section 165(c)(3). This amendment was made in order to provide that these losses were deductible in full and not subject to the $100 per casualty limitation or the 10-percent adjusted gross income floor applicable to personal casualty losses. However, the amendment inadvertently eliminated the deduction for these losses from the computation of the net operating loss. Also, the Tax Reform Act of 1986 provided that casualty losses described in section 165(c)(3) are not miscellaneous itemized deductions subject to the 2-percent adjusted gross income floor, and the Revenue Reconciliation Act of 1990 provided that these losses are not treated as itemized deductions in computing the overall limitation on itemized deductions. The losses of nonresident aliens are limited to deductions described in section 165(c)(3). Because of the change made by the 1984 Act, the reference to section 165(c)(3) does not include casualty and theft losses from nonbusiness transactions entered into for profit.

EXPLANATION OF PROVISION

The provision provides that all deductions for nonbusiness casualty and theft losses are taken into account in computing the net operating loss. Also, these deductions are not treated as miscellaneous itemized deductions subject to the 2-percent adjusted gross income floor, or as itemized deductions subject to the overall limitation on itemized deductions, and are allowed to nonresident aliens.

EFFECTIVE DATES

The provision relating to the net operating loss and the deduction for nonresident aliens applies to taxable years beginning after December 31, 1983.

The provision relating to miscellaneous itemized deductions applies to taxable years beginning after December 31, 1986.

The provision relating to the overall limitation on itemized deductions applies to taxable years beginning after December 31, 1990.

D. Disclosure of Tax Return Information to the Department of Agriculture (sec. 505(a) of the bill and sec. 6103 (j) of the Code)

PRESENT LAW

Tax return information generally may not be disclosed, except as specifically provided by statute. Disclosure is permitted to the Bureau of the Census for specified purposes, which included the responsibility of structuring, conducting, and preparing the census of agriculture (sec. 6103(j)(1)). The Census of Agriculture Act of 1997 (P.L. 105–113) transferred this responsibility from the Bureau of the Census to the Department of Agriculture.

EXPLANATION OF PROVISION

The provision permits the continuation of disclosure of tax return information for the purpose of structuring, conducting, and preparing the census of agriculture by authorizing the Department of Agriculture to receive this information.

EFFECTIVE DATE

The provision is effective on the date of enactment of this technical correction.

E. Technical Corrections to the Transportation Equity Act for the 21st Century (sec. 505(b) of the bill, sec. 9004 of the Act, and sec. 9503(f) of the Code)

PRESENT LAW

The Transportation Equity Act for the 21st Century ("Transportation Equity Act") (P.L. 105–178) extended the Highway Trust Fund and accompanying highway excise taxes. The Transportation Equity Act also changed the budgetary treatment of Highway Trust Fund expenditures, including repeal of a provision that balances maintained in the Highway Trust Fund pending expenditure earn interest from the General Fund of the Treasury.

EXPLANATION OF PROVISION

The provision clarifies that the Secretary of the Treasury is not required to invest Highway Trust Fund balances in interest-bearing obligations (because any interest paid to the Trust Fund by the General Fund would be immediately returned to the General Fund).

TITLE VI. RENEWAL COMMUNITY PROVISIONS

(SECS. 601–606 OF THE BILL AND SECS. 39, 46, 48, 49, 50, 51, 62, 4973, 4975, 6047, 6104, 6693, AND NEW SECS. 1400E–M OF THE CODE)

PRESENT LAW

In general

Zones and communities designated under OBRA 1993

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 and three empowerment zones are located in rural areas.[3] 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); (3) special tax-exempt financing for certain zone facilities (described in more detail below); and (4) the so-called "brownfields" tax incentive, which allows taxpayers to expense (rather than capitalize) certain environmental remediation expenditures.[4]

The 95 enterprise communities are eligible for the special tax-exempt financing benefits and "brownfields" tax incentive, but not the other tax incentives (i.e., the wage credit and additional sec. 179 expensing) available in the empowerment zones. In addition to these tax incentives, OBRA 1993 provided that Federal grants would be made to designated empowerment zones and enterprise communities.

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[3] 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, and Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

[4] The environmental remediation expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site, generally meaning 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. Targeted areas include: (1) empowerment zones and enterprise communities as designated under OBRA 1993 and the 1997 Act (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. The "brownfields" provision (enacted in the 1997 Act) applies to eligible expenditures incurred in taxable years ending after date of enactment and before January 1, 2001.

The tax incentives (other than the "brownfields" incentive) 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).

Additional zones designated under 1997 Act

Two additional urban zones with same tax incentives as previously designated empowerment zones.—Pursuant to the Tax Relief Act of 1997 ("1997 Act"), the Secretary of HUD designated 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 the same tax incentives generally apply (i.e., the wage credit, additional expensing, special tax-exempt financing, and "brownfields" incentive) as are available within the empowerment zones authorized by OBRA 1993.[5] The two additional empowerment zones are subject to the same eligibility criteria under present-law section 1392 that apply to the original six urban empowerment zones.[6]

The two additional empowerment zones must be designated within 180 days after enactment of the 1997 Act (i.e., the designations must be made by February 1, 1998). However, a special rule provides that the designations of these two additional empowerment zones will not take effect until January 1, 2000 (and generally will remain in effect for 10 years).

20 additional urban and rural empowerment zones.—The 1997 Act also 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).[7] With respect to these additional empowerment zones, the present-law eligibility criteria are expanded slightly in comparison to the eligibility criteria provided for by OBRA 1993. First, the general square mileage limitations (i.e., 20 square miles for urban areas and 1,000 square miles 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 may be divided among up to three noncontiguous parcels. In addition, the general requirement that at least half of the nominated area consists of census tracts with poverty rates of 35 percent or more does not apply to the 20 additional empowerment zones. However, 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.[8] For this purpose, census tracts with populations

[5] The two additional empowerment zones are located in Cleveland and Los Angeles. The wage credit available in the two new urban empowerment zones is modified slightly to provide that the credit rate will be 20 percent for calendar years 2000–2004, 15-percent for calendar year 2005, 10 percent for calendar year 2006, and five percent for calendar year 2007. No wage credit will be available in the two new urban empowerment zones after 2007.

[6] In order to permit designation of these two additional empowerment zones, the 1997 Act increased the aggregate population cap applicable to urban empowerment zones from 750,000 to a cap of one million aggregate population for the eight urban empowerment zones.

[7] In contrast to OBRA 1993, areas located within Indian reservations are eligible for designation as one of the additional 20 empowerment zones under the 1997 Act.

[8] In lieu of the poverty criteria, outmigration may be taken into account in designating one rural empowerment zone.

under 2,000 are treated as satisfying the 25-percent poverty rate criteria if (1) at least 75 percent of the tract was 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.[9]

Within the 20 additional empowerment zones, qualified "enterprise zone businesses" are eligible to receive up to $20,000 of additional section 179 expensing[10] and to utilize special tax-exempt financing benefits. The "brownfields" tax incentive (described above) also is available within all designated empowerment zones. However, businesses within the 20 additional empowerment zones are *not* eligible to receive the present-law wage credit available within the 11 other designated empowerment zones (i.e., the wage credit is available only within the nine zones designated under OBRA 1993 and the two urban zones designated under the 1997 Act that are eligible for the same tax incentives as are available in the nine zones designated under OBRA 1993).

The 20 additional empowerment zones are required to be designated before 1999, and the designations generally will remain in effect for 10 years.[11]

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 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

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[9] A special rule enacted as part of the 1997 Act modifies the present-law empowerment zone and enterprise community designation criteria so that any zones or communities designated in the future in the States of Alaska or Hawaii will not be subject to the general size limitations, nor will such zones or communities be subject to the general poverty-rate criteria. 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).

[10] However, the additional section 179 expensing is *not* available within the additional 2,000 acres allowed to be included under the 1997 Act within an empowerment zone.

[11] In addition, the 1997 Act also provides for special tax incentives (some of which are modeled after the empowerment zone tax incentives, but which also include a zero percent capital gains rate for certain qualified assets) for the District of Columbia.

or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community;[12] (2) at least 50 percent[13] of the total gross income is derived from the active conduct of a "qualified business" within a zone or community; (3) a substantial portion of the business' tangible property is used within a zone or community; (4) a substantial portion of the business' intangible property is used in the active conduct of such business; (5) a substantial portion 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) less 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.[14] 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.[15] The rental of tangible personal property to others is not a qualified business unless at least 50 percent 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. However, a special rule (enacted in the 1997 Act) provides that certain "new empowerment zone facility bonds" issued for qualified enterprise zone businesses in the 20 additional empowerment zones are not subject to the State private activity bond volume caps or the special limits on issue size generally applicable to qualified enterprise zone facility bonds.[16]

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[17]) the principal user of which is

[12] A qualified proprietorship is not required to meet the requirement that the sole trade or business of the proprietor is the active conduct of a qualified business within the empowerment zone or enterprise community.

[13] The 1997 Act reduced this threshold from 80 percent (as enacted in OBRA 1993) to 50 percent.

[14] 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.

[15] The 1997 Act provides that the lessor of property may rely on a lessee's certification that such lessee is an enterprise zone business.

[16] The maximum amount of "new empowerment zone facility 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.

[17] A special rule (enacted in the 1997 Act) relaxes the rehabilitation requirement for financing existing property with qualified enterprise zone facility bonds. In the case of property which is

Continued

an "enterprise zone business" (also defined above[18]), or (2) functionally related and subordinate land located in the empowerment zone or enterprise community.[19] 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.

REASONS FOR CHANGE

The Committee believes that the tax incentives available in empowerment zones and enterprise communities are inadequate to address the problems of distressed rural and urban areas. Revitalization of economically distressed areas through expanded business and employment opportunities should help alleviate both economic and social problems in such areas.

EXPLANATION OF PROVISION

The bill authorizes the designation of 20 "renewal communities" within which special tax incentives will be available. The following is a description of the designation process and the tax incentives that are available within the proposed renewal communities.

DESIGNATION PROCESS

Designation of 20 renewal communities.—Under the bill, the Secretary of HUD is authorized to designate up to 20 "renewal communities" from areas nominated by States and local governments. At least 20 percent of the designated communities must be in rural areas (defined as areas which (1) are within local government jurisdictions with a population less than 50,000, (2) are outside of a metropolitan statistical area, or (3) are determined by HUD to be a rural area). The Secretary of HUD is required to publish (within four months after enactment) regulations describing the selection process, and all designations of renewal communities would have to be made within 24 months after such regulations are published.

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substantially renovated by the taxpayer, the property need not be acquired by the taxpayer after zone or community designation and need not be originally used by the taxpayer within the zone if, during any 24-month period after zone or community designation, the additions to the taxpayer's basis in the property exceed 15 percent of the taxpayer's basis at the beginning of the period, or $5,000 (whichever is greater).

[18] 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.

A special rule (enacted in the 1997 Act) 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 the first three taxable years after the startup period.

[19] A special rule (enacted in the 1997 Act) waives until the end of a "startup period" the requirement that 95 percent or more of the proceeds of a bond issue be used by a qualified enterprise zone business. With respect to each property, the startup period would end 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 available only if, at the beginning of the startup period, there is a reasonable expectation that the use by a qualified enterprise zone business will be satisfied at the end of the startup period and the business makes bona fide efforts to satisfy the enterprise zone business definition.

Designations generally remain in effect through December 31, 2006.

Old empowerment zones and enterprise communities may seek additional designation as renewal communities.—The bill allows the previously designated empowerment zones and enterprise communities to be eligible for designation as renewal communities. Priority would be given in the designation of the first 50 percent of renewal communities to nominated areas which are empowerment zones or enterprise communities under present law and which otherwise meet the requirements of the proposal for designation as a renewal community. If a previously designated empowerment zone or enterprise community is selected as one of the 20 renewal communities, then the area's designation as a empowerment zone or enterprise community would remain in effect and the same area would also be designated as a renewal community. For such an area obtaining dual-designation status, the special tax incentives available for empowerment zones (or enterprise communities, as the case may be) *and* for renewal communities are available. If an area previously designated as an empowerment zone or enterprise community does not seek designation (or is not selected by the Secretary of HUD) as a renewal community, then the present-law empowerment zone and enterprise community provisions continue to apply to that area.

Eligibility criteria.—To be designated as a renewal community, a nominated area must meet all of the following criteria: (1) each census tract must have a poverty rate of at least 20 percent; (2) at least 70 percent of the households have incomes below 80 percent of the median income of households within the local government jurisdiction; (3) the unemployment rate is at least 1.5 times the national unemployment rate; and (4) the area is one of pervasive poverty, unemployment, and general distress.

Except with respect to the designation of the first 50 percent of renewal communities under which priority is given to existing empowerment zones and enterprise communities (as described above), those areas with the highest average ranking of factors (1), (2), and (3) above would be designated as renewal communities. The Secretary of HUD could also take into account in selecting areas for designation the extent to which such areas have a high incidence of crime, as well as whether the area has census tracts identified in the May 12, 1998, report of the General Accounting Office regarding the identification of economically distressed areas.

There are no geographic size or maximum population limitations placed on the designated renewal communities. The bill merely requires that the boundary of a designated community be "continuous" and that the designated community have a population of at least 4,000 if the community is located within a metropolitan statistical area (at least 1,000 in all other cases, or the community must be entirely within an Indian reservation).

Required State and local government course of action.—In order for an area to be designated as a renewal community, the bill requires State and local governments to submit a written course of action which promises within the nominated area at least five of the following: (1) a reduction of tax rates or fees; (2) an increase in the level of efficiency of local services; (3) crime reduction strategies; (4) actions to remove or streamline governmental requirements; (5) involvement by private entities and community groups, such as to provide jobs and job training and financial assistance; (6) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a government entity; and (7) the gift (or sale at below fair market value) of surplus realty by the State or local government to community organizations or private companies.

In addition, the bill requires that the nominating State and local governments promise to promote economic growth in the nominated area by repealing or not enforcing (1) licensing requirements for occupations that do not ordinarily require a professional degree, (2) zoning restrictions on home-based businesses which do not create a public nuisance, (3) permit requirements for street vendors who do not create a public nuisance, (4) zoning or other restrictions that impede the formation of schools or child care centers, and (5) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling, unless such regulations are "well-tailored to the protection of health and safety."

Tax incentives for renewal communities

The following tax incentives generally are available during the seven-year period beginning January 1, 2000, and ending December 31, 2006.

100-percent capital gain exclusion.—The bill provides for a 100 percent capital gains exclusion for qualified capital gain from the sale of a qualified community asset acquired after December 31, 1999, and before January 1, 2007, and held for more than five years. A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock acquired for cash in a "renewal community business," defined below); (2) qualified community partnership interest (meaning a partnership interest acquired for cash in a renewal community business); and (3) qualified community business property (meaning tangible real and personal property used in a renewal community business, if acquired (or substantially improved) by the taxpayer after December 31, 1999, and before January 1, 2007). The exclusion is available only if during substantially all of the taxpayer's holding period, the corporation or partnership qualifies as a renewal community business, or substantially all of the use of the property is in a renewal community business. Property continues to be a "qualified community asset" if sold (or otherwise transferred) to a subsequent purchaser, provided that the property continues to represent an interest in (or is tangible property used in) a renewal community business. In the case of the termination of an area's status as a renewal community, the amount of gain eligible for the exclusion cannot exceed the amount that would have been excludable had the property been sold on the date of the termination of status. Any gain attributable to the period before January 1, 2000, and after December 31, 2006, is not eligible for the 100-percent capital gains exclusion.

A "renewal community business" for purposes of the capital gain exclusion, as well as for purposes of the increased expensing under section 179 (described below), generally must satisfy the requirements of an "enterprise zone business" under present law; however, at least 50 percent (as opposed to 80 percent) of the total gross income of the business must be derived from the active conduct of a "qualified business" within a renewal community.

Family development accounts.—Under the bill, individual taxpayers are allowed to claim an above-the-line deduction for certain amounts paid in cash to a family development account ("FDA") established for the benefit of a "qualified individual," meaning an individual who both resides in a renewal community throughout the taxable year and who was allowed to claim the earned income tax credit ("EITC") during the preceding taxable year. An FDA is subject to rules similar to the rules for Individual Retirement Arrangements ("IRAs"). No deduction is allowed for any amount paid to an FDA for a taxable year beginning after December 31, 2006.

A qualified individual may claim a deduction for a taxable year for amounts contributed to his or her FDA(s) of up to the lesser of (1) $2,000 or (2) the amount of the individual's compensation included in gross income for the year. Any other person may deduct up to $1,000 per year for amounts contributed to an FDA established on behalf of a qualified individual. Under the bill, no more than $3,000 of contributions (excluding certain demonstration program matching contributions described below) can be made to the FDAs of a qualified individual in any taxable year. Contributions to an FDA may be made on or before April 15th of the following taxable year. The bill permits (but does not require) individuals to direct that the IRS directly deposit their EITC refunds into an FDA on behalf of such individual.

The bill provides that up to 5 of the renewal communities may be designated by the Secretary of HUD as "FDA matching demonstration areas," with respect to which HUD will, at the request of a qualified individual, match amounts contributed to FDAs, up to $1,000 per individual per taxable year (with a $2,000 lifetime cap). At least 2 of the FDA matching demonstration areas must be rural areas. The Secretary of HUD may designate renewal communities as FDA matching demonstration areas only during the 24-month period after such Secretary prescribes regulations regarding such areas. The matching grant amounts made under this demonstration program are excluded from the gross income of the account holder, and no deduction is allowed for matching grant amounts. The Secretary of the Treasury is required to provide notice to residents of FDA matching demonstration areas of the availability of matching contributions.

The bill provides that an FDA is exempt from taxation (other than the unrelated business income tax imposed by present-law section 511). Distributions from an FDA that are qualified family development distributions are not included in gross income. A distribution from an FDA is a qualified family development distribution if the distribution is used exclusively to pay (1) qualified post-secondary educational expenses, (2) certain first-time homebuyer expenses, (3) certain qualified business capitalization costs, or (4) qualified medical expenses. Such qualified expenses must be incurred on behalf of the FDA account holder, or the spouse or dependent of the account holder. Distributions from an FDA that are not qualified family development distributions are included in gross income and subject to either a 100-percent penalty tax (in the case of a distribution attributable to a demonstration matching contribution) or a 10-percent penalty tax (in the case of a distribution that is not attributable to a demonstration matching contribution). The 100-percent and 10-percent penalty taxes do not apply to distributions that are made on or after the account holder attains age 59½, dies, or becomes disabled. Any distribution from an FDA that is not a qualified family development distribution is deemed to have been made from demonstration matching contributions (and, therefore, subject to a 100-percent penalty) until all such demonstration matching contributions have been withdrawn. The purpose of this rule is to encourage account holders to use the amounts contributed to the FDA for qualified family development distributions or to save such amounts for retirement.

The bill permits tax-free (and penalty-free) rollovers of amounts in an FDA into another such account established for the benefit of an individual who (1) both resides in a renewal community throughout the taxable year and was allowed to claim the earned income tax credit during the preceding taxable year, and (2) either is the account holder or is a spouse or dependent of the account holder.

Commercial revitalization credit.—The bill allows taxpayers to claim a nonrefundable "commercial revitalization credit" equal to: (1) a 20-percent credit rate for the year a qualified building is placed in service or, if the taxpayer elects, (2) a 5-percent credit rate for each year during a 10-year period after the building is placed in service for costs (up to $10 million per building) of constructing or substantially rehabilitating one or more buildings used for commercial purposes in a designated renewal community. A qualified building must be located in a renewal community and be placed in service after December 31, 1999, and before January 1, 2007. Under the bill, each State is allowed to allocate no more than $2 million of credits to each renewal community located within the State for each calendar year.

Additional section 179 expensing.—A renewal community business (defined above) is allowed an additional $35,000 of section 179 expensing for qualified renewal property placed in service after an area is designated a renewal community. Thus, if a renewal community business is located in an area that is designated as both an empowerment zone and a renewal community, such business could be allowed an additional $55,000 of section 179 expensing (i.e., $20,000 of additional expensing because the area is designated an empowerment zone plus $35,000 of additional expensing because the area is designated a renewal community). As under present law, the section 179 expensing allowed to a taxpayer is phased out if the cost of section 179 property placed in service during the year by the taxpayer exceeds $200,000.

Expensing of environmental remediation costs ("brownfields").—Under the bill, taxpayers can elect to treat certain environmental remediation expenditures that would otherwise be chargeable to capital account as deductible in the year paid or incurred. The expenditure must be incurred in connection with the abatement or control of environmental contaminants, as required by Federal and State law, at a trade or business site located within a designated renewal community. This provision makes available to taxpayers located in renewal communities the "brownfields" provision enacted as part of the 1997 Act, which allows taxpayers to expense certain environmental remediation expenditures on property located in an empowerment zone, enterprise community, or certain other designated areas. This provision applies to expenditures incurred after December 31, 1999, and before January 1, 2007.

Extension of work opportunity tax credit.—The bill permits employers to claim the Work Opportunity Tax Credit ("WOTC") with respect to individuals hired from one or more targeted groups that live and perform substantially all of their work in a renewal community. The WOTC is available to an employer if (1) the employer is engaged in a trade or business in a renewal community throughout the one-year period for which the credit is being claimed, (2) the individual with respect to whom the WOTC is claimed is a resident of the renewal community throughout the one-year period, and (3) substantially all of the services which the individual performs for the employer during the one-year period are performed in the renewal community. The availability of the WOTC in renewal communities expires with respect to wages paid after December 31, 2006.[20] Under this provision, the WOTC with respect to a qualifying individual is 15 percent of qualified first-year wages and 30 percent of qualified second-year wages. No more than $10,000 of wages may be taken into account in each year. Thus, the maximum credit for a qualifying individual is $1,500 with respect to qualified first-year wages and $3,000 with respect to qualified second-year wages. Qualified wages generally consist of wages paid or incurred during the one-year period for which the WOTC is being calculated.

Targeted groups eligible for the credit include: (1) certain individuals certified by the designated local employment agency as being a member of a family eligible to receive benefits under the Temporary Assistance for Needy Families program ("TANF"); (2) certain ex-felons having a hiring date within one year of release from prison or date of conviction; (3) individuals who are at least 18 but not 25 years of age and have a principal place of abode within an empowerment zone, enterprise community, or renewal community; (4) individuals who are at least 18 but not 25 years of age who are certified 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; (5) 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; (6) individuals who are 16 or 17 years of age, perform services during any 90-day period between May 1 and September 15, and have a principal place of abode within an empowerment zone, enterprise community, or renewal community; (7) certain veterans who receive food stamps; and (8) recipients of certain ("SSI") Supplemental Security Income benefits.

[20] The Work Opportunity Tax Credit expired July 1, 1998. Section 302 of the bill extends the Work Opportunity Tax Credit through February 29, 2000.

Treasury reports.—The bill provides that, not later than the close of the fourth calendar year after the year the Secretary of HUD first designates an area as a renewal community and every four years thereafter, the Secretary of Treasury must report to Congress on the effects of such designation in stimulating the creation of new jobs, particularly for disadvantaged workers and long-term unemployed individuals, and promoting the revitalization of economically distressed areas.

EFFECTIVE DATE

Under the bill, renewal communities must be designated within 24 months after publication of certain regulations by HUD. The tax benefits available in renewal communities generally are effective for the 7-year period beginning January 1, 2000, and ending December 31, 2006.

III. VOTES OF THE COMMITTEE

In compliance with clause 2(l)(2)(B) of Rule XI of the Rules of the House of Representatives, the following statements are made concerning the votes of the Committee on Ways and Means in its consideration of the bill, H.R. 4579.

Motion to report the bill

The bill, H.R. 4579, as amended, was ordered favorably reported by a roll call vote of 23 yeas to 15 nays (with a quorum being present). The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	X		Mr. Rangel		X
Mr. Crane	X		Mr. Stark		X
Mr. Thomas	X		Mr. Matsui		X
Mr. Shaw	X		Mrs. Kennelly	X	
Mrs. Johnson	X		Mr. Coyne		X
Mr. Bunning	X		Mr. Levin		X
Mr. Houghton	X		Mr. Cardin		X
Mr. Herger	X		Mr. McDermott		X
Mr. McCrery	X		Mr. Kleczka		X
Mr. Camp	X		Mr. Lewis		X
Mr. Ramstad	X		Mr. Neal		X
Mr. Nussle	X		Mr. McNulty		X
Mr. Johnson	X		Mr. Jefferson		X
Ms. Dunn	X		Mr. Tanner		X
Mr. Collins	X		Mr. Becerra		X
Mr. Portman			Mrs. Thurman		X
Mr. English	X				
Mr. Ensign	X				
Mr. Christensen	X				
Mr. Watkins	X				
Mr. Hayworth	X				
Mr. Weller	X				
Mr. Hulshof	X				

Vote on amendment

A roll call vote was conducted on the following amendment to the Chairman's amendment in the nature of a substitute.

An amendment by Mr. Rangel, that would make the bill's provisions contingent upon attaining long-term solvency within the Social Security system, but permitting the provisions of the bill which extend expiring provisions (together with a revenue offset) and increase the Social Security earnings limitation (and the budget offsets) to take effect immediately, was defeated by a roll call vote of 15 yeas to 23 nays. The vote was as follows:

Representatives	Yea	Nay	Representatives	Yea	Nay
Mr. Archer	....	X	Mr. Rangel	X	....
Mr. Crane	....	X	Mr. Stark	X	....
Mr. Thomas	....	X	Mr. Matsui	X	....
Mr. Shaw	....	X	Mrs. Kennelly	....	....
Mrs. Johnson	....	X	Mr. Coyne	X	....
Mr. Bunning	....	X	Mr. Levin	X	....
Mr. Houghton	....	X	Mr. Cardin	X	....
Mr. Herger	....	X	Mr. McDermott	X	....
Mr. McCrery	....	X	Mr. Kleczka	X	....
Mr. Camp	....	X	Mr. Lewis	X	....
Mr. Ramstad	....	X	Mr. Neal	X	....
Mr. Nussle	....	X	Mr. McNulty	X	....
Mr. Johnson	....	X	Mr. Jefferson	X	....
Ms. Dunn	....	X	Mr. Tanner	X	....
Mr. Collins	....	....	Mr. Becerra	X	....
Mr. Portman	....	X	Mrs. Thurman	X	....
Mr. English	....	X			
Mr. Ensign	....	X			
Mr. Christensen	....	X			
Mr. Watkins	....	X			
Mr. Hayworth	....	X			
Mr. Weller	....	X			
Mr. Hulshof	....	X			

IV. BUDGET EFFECTS OF THE BILL

A. Committee Estimates

In compliance with clause 7(a) of Rule XIII of the Rules of the House of Representatives, the following statement is made concerning the estimated budget effects of H.R. 4579, as reported by the Committee.

The bill, as reported, is estimated to have the following budget effects:

ESTIMATED BUDGET EFFECTS OF H.R. 4579, THE ''TAXPAYER RELIEF ACT OF 1998'' AS APPROVED BY THE COMMITTEE ON WAYS AND MEANS

[By fiscal years in millions of dollars]

Provision	Effective	1999	2000	2001	2002	2003	1999–2003
I. Family Tax Relief Provisions:							
A. Marriage Penalty Tax Relief—adjust the standard deduction so that it is twice that of the standard deduction for a single taxpayer; make uniform additional standard deduction for the blind and elderly.	tyba 12/31/98	−3,517	−5,935	−6,057	−6,255	−6,310	−28,074
B. $200/$400 Exclusion for Interest and Dividends	tyba 12/31/98	−693	−3,472	−3,521	−3,599	−3,669	−14,954
C. Treatment of Nonrefundable Personal Credits (child credit, adoption, credit, HOPE and Lifetime Learning credits, etc.) Under the Alternative Individual Minimum Tax.	tyba 12/31/97	−1,042	−1,103	−1,442	−1,911	−2,577	−8,075
D. Suspension of 5-Year Holding Period Relating to Gain on Sale of Principal Residence for Members of the Uniformed Services and the Foreign Service Serving Outside the Area in Which the Property is Located.	sa DOE	−5	−12	−12	−13	−13	−54
Subtotal of Family Tax Relief Provisions		−5,257	−10,522	−11,032	−11,778	−12,569	−51,157
II. Education and Infrastructure Provisions:							
A. Permit Private Higher Education Schools to Establish Qualified Prepaid Tuition Programs	ci tyba 12/31/98	−43	−117	−127	−137	−148	−572
B. Provide a 4-Year Exception from Arbitrage Rebate for Tax-Exempt Bonds Issued to Finance Public School Construction.	bia 12/31/98	−86	−238	−343	−379	−332	−1,379
C. Increase Private Activity Bond Volume Cap to the Greater of $75 Per Capita or $225 Million.	1/1/99	−16	−111	−225	−329	−425	−1,107
D. Designate 20 Renewal Communities; Provide Various Incentives Starting 1/1/00, Including 100% Capital Gains Exclusion on Certain Investments.	DOE	−3	−156	−256	−282	−343	−1,039
Subtotal of Education and Infrastructure Provisions		−148	−622	−951	−1,127	−1,248	−4,097
III. Small Business and Farmer Tax Relief Provisions:							
A. Accelerate the $1 Million Estate Tax Unified Credit Exemption	dda 12/31/98		−4,381	−4,278	−4,641	−4,626	−17,926
B. Accelerate 100% Deduction for Health Insurance Premiums of Self-Employed Individuals	tybe 12/31/98	−415	−1,247	−1,249	−1,241	−959	−5,111
C. Accelerate $25,000 Small Business and Farmer Expensing	tyba 12/31/98	−600	−945	−140	−319	−307	−1,059
D. Permanent Extension of Income Averaging for Farmers	tyba 12/31/00			−2	−21	−22	−45
E. Extend the Net Operating Loss Carryback Period for Farmer Losses	NOLgi tyba 12/31/97	−20	−18	−16	−14	−13	−81
F. Farmers Production Flexibility Contract Payments Not Included in Income Prior to Receipt	DOE	−98	98				
Subtotal of Small Business and Farmer Tax Relief Provisions		−1,133	−6,493	−5,685	−5,598	−5,313	−24,222

IV. Extension of Expiring Provisions:							
A. Extend the R&E Credit and Increase the Rates for the Alternative Incremental Research Credit by 1-Percentage Point (through 2/29/00).	7/1/98	−1,543	−1,076	−677	−407	−249	−3,952
B. Extend the Work Opportunity Tax Credit (through 2/29/00)	wpoifibwa 6/30/98	−245	−245	−156	−67	−25	−737
C. Extend the Welfare to Work Tax Credit (through 2/29/00)	wpoifibwa 4/30/99	−14	−47	−37	−19	−8	−124
D. Permanently Extend Contributions of Appreciated Stock to Private Foundations; Public Inspection of Private Foundation Annual Returns.	7/1/98; tyea 12/31/98	−23	−56	−71	−83	−91	−324
E. 1-Year Modified Extension of Exemption from Subpart F for Active Financing Income	tybi 1999	−117	−378				−495
F. Extend the Generalized System of Preferences (through 2/29/00)[1]	7/1/98	−393	−142				−535
Subtotal of Extension of Expiring Provisions		−2,335	−1,944	−941	−576	−373	−6,167
V. Revenue Offset Provisions:							
A. Change the Treatment of Certain Deductible Liquidating Distributions of RICs and REITs	dma 5/21/98	2,425	1,109	723	640	672	5,569
Subtotal of Revenue Offset Provision		2,425	1,109	723	640	672	5,569
VI. Tax Technical Corrections Provisions							
Total of Revenue Provisions		−6,448	−18,472	−17,886	−18,439	−18,831	−80,074
Social Security Outlay Provisions[2]							
A. Accelerate Phase-in of $30,000 Earnings Test Limit	tyea 12/31/98	−175	−225	−150	−25	10	−565
B. Delay Benefit Recomputations	bma 12/31/98	10	140	140	140	140	570
Subtotal of Social Security Outlay Provisions		−165	−85	−10	115	150	5
Net Total		−6,613	−18,557	−17,896	−18,324	−18,681	−80,069

[1] Estimate provided by the Congressional Budget Office.
[2] Preliminary and unofficial estimates provided by the Congressional Budget Office.

Legend for "Effective" column; ci=contributions in; bia=bonds issued after; bma=benefits months after; dda=decedents dying after; dma=distributions made after; DOE=date of enactment; NOLgi=net operating losses generated in; sa=sales after; tyba=taxable years beginning after; tybi=taxable years beginning in; tyea=taxable years ending after; wpoifibwa=wages paid or incurred for individuals beginning work after.

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

Source: Joint Committee on Taxation.

B. Budget Authority and Tax Expenditures

Budget authority

In compliance with subdivision (B) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee states that the Social Security provisions (secs. 121 and 122) involve increased (sec. 121) and decreased (sec. 122) budget outlays. (See Part IV.A., above.)

Tax expenditures

In compliance with subdivision (B) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee states that the individual income tax reduction provisions (other than the increased standard deduction for married taxpayers), the business income tax reduction provisions (other than the provision relating to farmer production flexibility contract payments), and the extensions of expiring income tax provisions involve increased tax expenditures. The partial exclusion for individual interest and dividend income is a new tax expenditure to the Tax Code.

C. Cost Estimate Prepared by the Congressional Budget Office

In compliance with subdivision (C) of the clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, requiring a cost estimate prepared by the Congressional Budget Office ("CBO"), the Committee advises that the CBO has submitted the following statement on H.R. 4579, as reported.

U.S. Congress,
Congressional Budget Office,
Washington, DC, September 23, 1998.

Hon. Bill Archer,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, DC.

Dear Mr. Chairman: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4579, the Taxpayer Relief Act of 1998.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Hester Grippando (for revenues) and Kathy Ruffing.

Sincerely,

June E. O'Neil, *Director.*

Enclosure.

H.R. 4579—Taxpayer Relief Act of 1998

Summary: The Taxpayer Relief Act of 1998 is an omnibus tax bill that would amend exiting tax laws and extend numerous tax provisions that have expired recently or are about to expire. H.R. 4579 would also increase the amount that Social Security beneficiaries who are over the age of eligibility for full retirement benefits (currently 65) and under age 70 could earn without having their benefits reduced and would offset the resulting costs by delaying recomputations of benefits for recent earnings. The Congressional

Budget Office (CBO) and the Joint Committee on Taxation (JCT) estimate that H.R. 4579 would decrease governmental receipts by $80 billion over the 1999–2003 period. In addition, CBO estimates that this bill would reduce spending for Social Security by $5 million over the same period.

H.R. 4579 contains no intergovernmental mandates as defined in the unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments. The bill imposes one new private-sector mandate through changes in the treatment of certain deductible liquidating distributions of regulated investment companies and real estate investment trusts. The costs of the new mandate would exceed the threshold ($100 million in 1996, adjusted annually for inflation) specified in UMRA in fiscal years 1999–2003.

Description of major provisions: Title I, Provisions Primarily Affecting Individuals and Families, would:

Raise the standard deduction for married couples,

Provide for a partial exclusion of income from interest and dividends,

Change treatment of personal credits under the individual alternative minimum tax,

Accelerate the increase in the deduction for health insurance expenses for self-employed individuals,

Establish a special rule relating to gain on sale of principal residence for members of the uniformed forces and the foreign service serving outside the area where the property is located,

Accelerate the increase in the unified credit in the estate and gift tax,

Permit schools of higher education to establish qualified prepaid tuition programs,

Change the treatment of tax-exempt bonds issued to finance public school construction,

Increase the Social Security earnings limit for individuals who attained retirement age, and

Change the recomputation of benefits after normal retirement age.

Title II, Provisions Primarily Affecting Farming and Other Businesses, would:

Accelerate the increase in expensing for small businesses,

Permanently extend income averaging for farmers,

Extend the net operating loss carryback period for farmers,

Allow farmers not to include payments from production flexibility contracts in income prior to receipt, and

Increase state volume limits on private activity tax-exempt bonds.

Title III, Extension and Modification of Certain Expiring Provisions, would:

Extend the research and experimentation tax credit through February 29, 2000,

Extend the work opportunity tax credit through February 29, 2000,

Extend the welfare-to-work tax credit through February 29, 2000, Permanently extend the deduction provided for contributions of appreciated stock to private foundations,

Modify and extend for one year the exemption from Subpart F for active financing income, and

Extend the Generalized System of Preferences through February 29, 2000,

Title IV, Revenue Offset Provision, would change the treatment of certain deductible liquidating distributions of regulated investment companies and real estate investment trust.

Title V would make technical corrections to existing tax laws.

Title VI, The American Community Renewal Act of 1998, would designate 20 renewal communities and provide various tax incentives.

Estimated cost to the Federal Government: The estimated budgetary impact of H.R. 4579 is summarized in the following table. The costs of this legislation fall within budget function 650 (Social Security).

TABLE 1. SUMMARY OF ESTIMATED BUDGETARY EFFECTS OF H.R. 4579

[By fiscal year in millions of dollars]

	1998	1999	2000	2001	2002	2003
REVENUES						
Title I: Provisions Primarily Affecting Individuals and Families	0	−5,801	−16,505	−17,029	−18,176	−18,634
Title II: Provisions Primarily Affecting Farming and Other Businesses	0	−734	−976	−383	−45	−153
Title III: Extension and Modification of Certain Expiring Provisions	0	−2,335	−1,944	−941	−576	−373
Title IV: Revenue Offset	0	2,425	1,109	723	640	672
Title VI: American Community Renewal Act	0	−3	−156	−256	−282	−343
Total	0	−6,448	−18,472	−17,886	−18,439	−18,831
DIRECT SPENDING						
Spending under current law:						
Old-Age, Survivors, and Disability Insurance [1]	375,785	391,477	408,764	427,736	448,711	471,221
Proposed changes:						
Old-Age, Survivors, and Disability Insurance [1]	0	165	85	10	−115	−150
Spending under H.R. 4579						
Old-Age, Survivors, and Disability Insurance [1]	375,785	391,642	408,849	427,746	448,596	471,071
CHANGE IN SURPLUS						
Proposed changes:						
Off-budget	0	−165	−85	−10	115	150
On-budget	0	−6,448	−18,472	−17,886	−18,439	−18,831
Total	0	−6,613	−18,557	−17,896	−18,324	−18,681

[1] Spending from the Old-Age and Survivors Insurance and Disability Insurance trust funds is off-budget under current law.

Notes.—Components may not sum to totals due to rounding. The table does not include any spending that may occur subject to appropriations as a result of federal deposits to the family development accounts, authorized in title VI.

Source: Joint Committee on Taxation and Congressional Budget Office.

Basis of Estimate

Revenues

All the estimates for the revenue provisions, with the exception of the Generalized System of Preferences (GSP) in subtitle B of title III, were provided by the JCT.

The Taxpayer Relief Act of 1998 would renew GSP, which expired on June 30, 1998, through February 29, 2000. Taxpayers could apply for refunds for the period between July 1, 1998, and October 1, 1998. GSP affords nonreciprocal tariff preferences to approximately 140 developing countries to aid their economic development and to diversify and expand their production and exports. Generally, duty-free treatment of imported goods from GSP-designated developing countries is extended to products that are not competitive internationally. The program contains safeguards to protect domestic industries that are sensitive to import competition. CBO estimates that renewing GSP would reduce governmental receipts by $393 million in fiscal year 1999, $142 million in fiscal year 2000, and a total of $535 million over the 1999–2000 period, net of payroll and income tax offsets. This estimates is based on projections of U.S. imports and recent data on collections from beneficiary countries under the GSP program.

Provisions Relating to Social Security

Subtitle C of title I contains two provisions relating to Social Security.

Earnings Limit.—Section 121 of H.R. 4579 would increase the amount that certain Social Security beneficiaries could earn without having their benefits reduced. Under current law, for beneficiaries over retirement age (currently 65) and younger than age 70, one dollar of benefits is withheld for every three dollars of earnings above a threshold, which equals $14,500 in 1998. A stricter test applies to retired workers between the ages of 62 and 64; beneficiaries above the age of 70 are exempt. This year's limit of $14,500 was set two years ago in the Contract with America Advancement Act (Public Law 104–121), and will increase to $30,000 by 2002 and in step with average wages thereafter. This bill would raise the exempt amount of earnings in each of the next ten years except 2002 (see Table 2).

TABLE 2. EARNINGS TEST FOR CERTAIN SOCIAL SECURITY BENEFICIARIES UNDER CURRENT LAW AND H.R. 4579

Calendar year	Exempt amount under current law [1]	Exempt amount under H.R. 4579	Difference	Affected age group
1998	$14,500	$14,500	0	65 to 70
1999	15,500	17,000	1,500	65 to 70
2000	17,000	18,500	1,500	65 to 70
2001	25,000	26,000	1,000	65 to 70
2002	30,000	30,000	0	65 to 70
2003	31,200	31,300	100	65 and 2 months to 70
2004	32,520	34,000	1,480	65 and 4 months to 70
2005	33,840	35,400	1,560	65 and 6 months to 70
2006	35,160	36,800	1,640	65 and 8 months to 70
2007	36,600	38,350	1,750	65 and 10 months to 70

TABLE 2. EARNINGS TEST FOR CERTAIN SOCIAL SECURITY BENEFICIARIES UNDER CURRENT LAW AND H.R. 4579—Continued

Calendar year	Exempt amount under current law [1]	Exempt amount under H.R. 4579	Difference	Affected age group
2008	37,920	39,750	1,830	66 to 70

[1] Through 2002, these amounts are set in the Contract With America Advancement Act (Public Law 104–121). After 2002, they are indexed to overall wage increases. A lower limit applies to beneficiaries who have not reached the age for full (unreduced) retirement benefits.

In calendar years 1999 and 2000, CBO estimates that the proposed increase in the earnings limit would lead to extra Social Security outlays of about $225 million each year. Because the increase would not take effect until January 1999, the cost in fiscal year 1999 would be only about $175 million. In those years, based on information from the Social Security Administration (SSA), CBO estimates that about 500,000 beneficiaries would receive benefit increase. The maximum gain in those years for a beneficiary would be $500 (that is, the proposed $1,500 increase times the one-third reduction in benefits that the recipient would experience under current law); of course, not all of those affected would receive the maximum increase. The costs of the bill would fall after 2000 for several reasons. First, the retirement age is scheduled to increase under current law, effective for people reaching age 62 in 2000 (age 65 in 2003), and fewer people will be in the relevant age bracket. Second, the threshold for the earnings test is already scheduled to climb steeply under current law, and fewer people will exceed it. Finally, those older workers who benefit form this proposal will thereby forfeit a part of their delayed retirement credit for the rest of their lifetimes. In 2003, for example, when the proposed change in the earnings test itself is negligible, CBO estimates that about $10 million would be saved, on balance, by virtue of the delayed retirement credit (see Table 3).

Delay In Benefit Recomputations.—Benefits for retired workers are essentially computed by averaging the highest 35 years of the worker's earnings and applying a benefit formula. When a retiree continues to have earnings, SSA checks to see whether substituting that year of earnings—in lieu of one of the other 35 years—would lead to a higher benefit. Those recomputations are based on the annual earnings that employers report to the Internal Revenue Service. About 85 percent of such earnings are posted within 6 months of the close of the calendar year, and about 98 percent within 9 months. Because of this lag, recomputations—which are now effective for the January immediately after the year of earnings—typically lead to a lump-sum payment of retroactive benefits when they are finally processed.

Section 122 of H.R. 4579 provides that, in most cases, the recomputation would raise benefits effective in January of the second year following the earnings. That is, benefits for the year after the earnings we received would not reflect those earnings. H.R. 4579 would make an exception in cases where that latest year of earnings would substitute for a year of zero earnings in the beneficiary's previous high 35. The provision would apply only to beneficiaries who have reached retirement age and would be effective beginning with earnings in 1998. Because SSA would not have processed most of those recomputations until late in the fiscal year, savings in 1999 are estimated at just $10 million. Thereafter, the proposal is estimated to affect nearly 1 million beneficiaries a year for annual savings of $140 million.

TABLE 3. ESTIMATED BUDGETARY EFFECTS OF SPENDING PROVISIONS OF H.R. 4579

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Section 121. Increase earnings limit for Social Security beneficiaries over the age of retirement	175	225	150	25	−10	110	150	150	150	150
Section 122. Delay recomputation of benefits for certain Social Security beneficiaries over the age of retirement	−10	−140	−140	−140	−140	−140	−140	−140	−140	−140

Note.—These provisions would affect benefit outlays from the Old-Age and Survivors Insurance trust fund, which is off-budget.

Source: Congressional Budget Office.

Pay-as-you-go considerations: The Balanced Budget and Emergency Deficit Control Act of 1985 establishes pay-as-you-go procedures for legislation affecting direct spending or receipts. Only changes affecting on-budget outlays and receipts (that is, those in non-Social Security programs) affect the pay-as-you-go scorecard. For purposes of enforcing pay-as-you-go procedures, only the effects in the current year, budget year, and the succeeding four years are counted (see Table 4).

TABLE 4. SUMMARY OF PAY-AS-YOU-GO EFFECTS OF H.R. 4579

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Change in outlays	0	0	0	0	0	0	0	0	0	0
Change in receipts	−6,448	−18,472	−17,886	−18,439	−18,831	−19,738	−18,620	−18,523	−19,119	−21,034

Sources: Congressional Budget Office and Joint Committee on Taxation.

Social Security outlays and receipts do not appear on the pay-as-you-go scorecard, but the House of Representatives tracks them separately. That tally includes effects only for the year in which the legislation takes effect and the four subsequent years; for H.R. 4579, the relevant years are 1999 through 2003. The scorecard also includes balances carried over from laws enacted in previous years, such as the Contract with American Advancement Act, enacted in 1996 (see Table 5).

TABLE 5. CBO ESTIMATE OF CURRENT STATUS OF THE SOCIAL SECURITY SCORECARD IN THE HOUSE OF REPRESENTATIVES

[By fiscal year, in millions of dollars]

	1999	2000	2001	2002	2003
Scorecard at start of 1999:					
OASDI taxes	80				
OASDI benefits	−114	75			
Net Effect	194	−75			
Effect of Taxpayer Relief Act of 1998 (H.R. 4579):					
OASDI taxes					
OASDI benefits	165	85	10	−115	−150
Net Effect	−165	−85	−10	115	150
Scorecard assuming enactment of H.R. 4579:					
OASDI taxes	80				
OASDI benefits	51	160	10	−115	−150
Net effect	29	−160	−10	115	150

Note. OASDI=Old-Age, Survivors, and Disability Insurance.

Sources: Congressional Budget Office and Joint Committee on Taxation.

Estimated impact on State, local, and tribal governments: Section 4 of UMRA excludes from the application of that act any legislative provisions that relate to the old-age, survivors, and disability insurance program under title II of the Soial Security Act. CBO has determined that all provisions of subtitle C of title I fit within that exclusion. CBO and JCT have determined that the remaining provisions of H.R. 4579 contain no intergovernmental mandates as defined in UMRA.

Estimated impact on the private Sector: JCT has determined that title IV would impose a new private-sector mandate on regulated investment companies and real estate in investment trusts by changing the treatment of certain deductible liquidating distributions. The direct costs of the new mandate would exceed the statutory threshold ($100 million in 1996, adjusted annually for inflation) established in UMRA in each of fiscal years 1999 through 2003 (see Table 6). UMRA does not apply to the provisions of subtitle C of title I. The other provisions of H.R. 4579 contain no private-sector mandates.

TABLE 6. ESTIMATED COST OF PRIVATE-SECTOR MANDATES

[By fiscal year, in millions of dollars]

	1998	1999	2000	2001	2002	2003
Cost to the private sector	0	2,425	1,109	723	640	672

Source: Joint Committee on Taxation.

Estimate prepared by: Federal spending: Kathy Ruffing and Deb Reis, Federal revenues: Hester Grippando; Impact on State, local, and tribal governments: Pepper Santalucia; Impact on the private sector: Lesley Frymier.

Estimate approved by: Frank Sammartino, Assistant Director for Tax Analysis (Acting); Paul N. Van de Water, Assistant Director for Budget Analysis.

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

A. COMMITTEE OVERSIGHT FINDINGS AND RECOMMENDATIONS

With respect to subdivision (A) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives (relating to oversight findings), the Committee advises that it was the result of the Committee's oversight activities with respect to providing tax relief for the marriage tax penalty, tax relief for modest amounts of interest and dividend income, individual minimum tax relief for taxpayers utilizing personal tax credits, education and community renewal tax incentives, small business and farmer tax relief, acceleration of the increased estate tax unified credit exemption, extension of certain expired and expiring tax and trade provisions, closing a tax loophole with respect to the treatment of certain deductible liquidating distributions of RICs and REITs, acceleration of the phase-in of increased Social Security earnings limit and delay of Social Security benefit recomputations, and necessary tax technical corrections that the Committee concluded that it is appropriate and timely to enact the provisions contained in the bill as reported.

B. SUMMARY OF FINDINGS AND RECOMMENDATIONS OF THE COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

With respect to subdivision (D) of clause 2(l)(3) of Rule XI of the Rules of the House of Representatives, the Committee advises that no specific oversight findings or recommendations have been submitted to this Committee by the Committee on Government Reform and Oversight with respect to the provisions contained in the bill.

C. CONSTITUTIONAL AUTHORITY STATEMENT

With respect to clause 2(l)(4) of Rule XI of the Rules of the House of Representatives (relating to Constitutional Authority), the Committee states that the Committee's action in reporting this bill is derived from Article I of the Constitution, Section 7 ("All bills for raising revenue shall originate in the House of Representatives") and Section 8 ("The Congress shall have the power to lay and collect taxes, duties, imports and excises, to pay the debts * * * of the United States"), and from the 16th Amendment to the Constitution.

D. INFORMATION RELATING TO UNFUNDED MANDATES

This information is provided in accordance with section 423 of the Unfunded Mandates Act of 1995 (P.L. 104–4).

The Committee has determined that the provision of the bill relating to treatment of certain deductible liquidating distributions of

RICs and REITs (bill sec. 401) will impose a Federal mandate on the private sector totaling $5,569 million for fiscal years 1999–2003. This amount is no greater than the aggregate estimated amounts the private sector will be required to pay in order to comply with this private sector mandate during this period. The bill will not impose a Federal intergovernmental mandate on State, local, or tribal governments.

E. Applicability of House Rule XXI 5(c)

Rule XXI 5(c) of the Rules of the House of Representatives provides, in part, that "No bill or joint resolution, amendment, or conference report carrying a Federal income tax rate increase shall be considered as passed or agreed to unless determined by a vote of not less than three-fifths of the Members." The Committee has carefully reviewed the provisions of the bill, and states that the provisions of the bill do not involve any Federal income tax rate increase within the meaning of the rule.

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

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

INTERNAL REVENUE CODE OF 1986

Subtitle A—Income Taxes

* * * * * * *

CHAPTER 1—NORMAL TAXES AND SURTAXES

Subchapter A. Determination of tax liability.

* * * * * * *

Subchapter X. Renewal communities.

Subchapter A—Determination of Tax Liability

* * * * * * *

PART I—TAX ON INDIVIDUALS

* * * * * * *

SEC. 1. TAX IMPOSED.

(a) * * *

* * * * * * *

(f) Adjustments in Tax Tables so That Inflation Will Not Result in Tax Increases.—

(1) * * *

* * * * * * *

(6) ROUNDING.—

(A) * * *

(B) TABLE FOR MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return, subparagraph (A) [(other than with respect to subsection (c)(4) of section 63 (as it applies to subsections (c)(5)(A) and (f) of such section) and section 151(d)(4)(A)) shall be applied] *(other than with respect to sections 63(c)(4) and 151(d)(4)(A)) shall be applied* by substituting "$25" for "$50" each place it appears.

* * * * * * *

(h) MAXIMUM CAPITAL GAINS RATE.—

(1) * * *

* * * * * * *

(13) SPECIAL RULES.—

(A) * * *

(B) DETERMINATION OF UNRECAPTURED SECTION 1250 GAIN.—The amount determined under paragraph [(7)(A)] *(7)(A)(i)* shall not include gain—

(i) which is properly taken into account for the portion of the taxable year before May 7, 1997; or

(ii) from property held not more than 18 months which is properly taken into account for the portion of the taxable year after July 28, 1997, and before January 1, 1998.

* * * * * * *

PART IV—CREDITS AGAINST TAX

* * * * * * *

Subpart A—Nonrefundable Personal Credits

* * * * * * *

SEC. 24. CHILD TAX CREDIT.

(a) * * *

* * * * * * *

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

(1) * * *

[(2) REDUCTION OF CREDIT TO TAXPAYER SUBJECT TO ALTERNATIVE MINIMUM TAX.—The credit determined under this subsection for the taxable year shall be reduced by the excess (if any) of—

[(A) the amount of tax imposed by section 55 (relating to alternative minimum tax) with respect to such taxpayer for such taxable year, over

[(B) the amount of the reduction under section 32(h) with respect to such taxpayer for such taxable year.]

[(3)] *(2)* SOCIAL SECURITY TAXES.—For purposes of paragraph (1)—

(A) * * *

* * * * * * *

SEC. 25. INTEREST ON CERTAIN HOME MORTGAGES.

(a) * * *

* * * * * * *

(f) REDUCTION IN AGGREGATE AMOUNT OF QUALIFIED MORTGAGE BONDS WHICH MAY BE ISSUED WHERE CERTAIN REQUIREMENTS NOT MET.—

(1) * * *

* * * * * * *

(3) SPECIAL RULE FOR STATES HAVING CONSTITUTIONAL HOME RULE CITIES.—In the case of a State having one or more constitutional home rule cities (within the meaning of section ⟦146(d)(3)(C)⟧ *146(d)(2)(C)*), the reduction in the State ceiling by reason of paragraph (1) shall be allocated to the constitutional home rule city, or to the portion of the State not within such city, whichever caused the reduction.

* * * * * * *

SEC. 26. LIMITATION BASED ON TAX LIABILITY; DEFINITION OF TAX LIABILITY.

⟦(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the excess (if any) of—

⟦(1) the taxpayer's regular tax liability for the taxable year, over

⟦(2) the tentative minimum tax for the taxable year (determined without regard to the alternative minimum tax foreign tax credit).⟧

(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the sum of—

(1) the taxpayer's regular tax liability for the taxable year, and

(2) the tax imposed for the taxable year by section 55(a).

For purposes of applying the preceding sentence, paragraph (2) shall be treated as being zero for any taxable year beginning during 1998.

* * * * * * *

Subpart C—Refundable Credits

* * * * * * *

SEC. 32. EARNED INCOME.

(a) * * *

* * * * * * *

⟦(h) REDUCTION OF CREDIT TO TAXPAYERS SUBJECT TO ALTERNATIVE MINIMUM TAX.—The credit allowed under this section for the taxable year shall be reduced by the amount of tax imposed by section 55 (relating to alternative minimum tax) with respect to such taxpayer for such taxable year.⟧

Subpart D—Business Related Credits

* * * * * * *

SEC. 39. CARRYBACK AND CARRYFORWARD OF UNUSED CREDITS.

(a) * * *

* * * * * * *

(d) TRANSITIONAL RULES.—

(1) * * *

* * * * * * *

(9) NO CARRYBACK OF SECTION 1400K CREDIT BEFORE DATE OF ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to any commercial revitalization credit determined under section 1400K may be carried back to a taxable year ending before the date of the enactment of section 1400K.

* * * * * * *

SEC. 41. CREDIT FOR INCREASING RESEARCH ACTIVITIES.

(a) * * *

* * * * * * *

(c) BASE AMOUNT.—

(1) * * *

* * * * * * *

(4) ELECTION OF ALTERNATIVE INCREMENTAL CREDIT.—

(A) IN GENERAL.—At the election of the taxpayer, the credit determined under subsection (a)(1) shall be equal to the sum of—

(i) ⟦1.65⟧ *2.65* percent of so much of the qualified research expenses for the taxable year as exceeds 1 percent of the average described in subsection (c)(1)(B) but does not exceed 1.5 percent of such average,

(ii) ⟦2.2⟧ *3.2* percent of so much of such expenses as exceeds 1.5 percent of such average but does not exceed 2 percent of such average, and

(iii) ⟦2.75⟧ *3.75* percent of so much of such expenses as exceeds 2 percent of such average.

* * * * * * *

(h) TERMINATION.—

(1) IN GENERAL.—This section shall not apply to any amount paid or incurred—

(A) after June 30, 1995, and before July 1, 1996, or

(B) after ⟦June 30, 1998⟧ *February 29, 2000*.

Notwithstanding the preceding sentence, in the case of a taxpayer making an election under subsection (c)(4) for its first taxable year beginning after June 30, 1996, and before July 1, 1997, this section shall apply to amounts paid or incurred during the ⟦24-month⟧ *44-month* period beginning with the first month of such year. The ⟦24 months⟧ *44 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.

* * * * * * *

SEC. 42. LOW-INCOME HOUSING CREDIT.

(a) * * *

* * * * * * *

(h) LIMITATION ON AGGREGATE CREDIT ALLOWABLE WITH RESPECT TO PROJECTS LOCATED IN A STATE.—

(1) * * *

* * * * * * *

(3) HOUSING CREDIT DOLLAR AMOUNT FOR AGENCIES.—

(A) * * *

* * * * * * *

(E) SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—For purposes of this subsection—

(i) * * *

* * * * * * *

(iii) CONSTITUTIONAL HOME RULE CITY.—For purposes of this paragraph, the term "constitutional home rule city" has the meaning given such term by section ❲146(d)(3)(C)❳ *146(d)(2)(C)*.

* * * * * * *

SEC. 45C. CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES OR CONDITIONS.

(a) * * *

(b) QUALIFIED CLINICAL TESTING EXPENSES FOR PURPOSES OF THIS SECTION.—

(1) QUALIFIED CLINICAL TESTING EXPENSES.—

(A) * * *

* * * * * * *

(D) SPECIAL RULE.—For purposes of this paragraph, section 41 shall be deemed to remain in effect for periods after June 30, 1995, and before July 1, 1996, and periods after ❲June 30, 1998❳ *February 29, 2000*.

* * * * * * *

Subpart E—Rules for Computing Investment Credit

* * * * * * *

SEC. 46. AMOUNT OF CREDIT.

For purposes of section 38, the amount of the investment credit determined under this section for any taxable year shall be the sum of—

(1) the rehabilitation credit,

(2) the energy credit, ❲and❳

(3) the reforestation credit❲.❳*, and*

(4) the commercial revitalization credit provided under section 1400K.

* * * * * * *

SEC. 48. ENERGY CREDIT; REFORESTATION CREDIT.

(a) ENERGY CREDIT.—

(1) * * *

(2) ENERGY PERCENTAGE.—

(A) * * *

(B) COORDINATION WITH REHABILITATION *OR COMMERCIAL REVITALIZATION*.—The energy percentage shall not apply to that portion of the basis of any property which is attributable to qualified rehabilitation *or commercial revitalization* expenditures.

* * * * * * *

SEC. 49. AT-RISK RULES.

(a) GENERAL RULE.—

(1) CERTAIN NONRECOURSE FINANCING EXCLUDED FROM CREDIT BASE.—

(A) * * *

* * * * * * *

(C) CREDIT BASE DEFINED.—For purposes of this paragraph, the term "credit base" means—

(i) the portion of the basis of any qualified rehabilitated building attributable to qualified rehabilitation expenditures,

(ii) the basis of any energy property, [and]

(iii) the amortizable basis of any qualified timber property[.]*, and*

(iv) the portion of the basis of any qualified revitalization building attributable to qualified revitalization expenditures.

* * * * * * *

SEC. 50. OTHER SPECIAL RULES.

(a) RECAPTURE IN CASE OF DISPOSITIONS, ETC.—Under regulations prescribed by the Secretary—

(1) * * *

(2) PROPERTY CEASES TO QUALIFY FOR PROGRESS EXPENDITURES.—

(A) IN GENERAL.—If during any taxable year any building to which section 47(d) *or 1400K(d)(2)* applied ceases (by reason of sale or other disposition, cancellation or abandonment of contract, or otherwise) to be, with respect to the taxpayer, property which, when placed in service, will be a qualified rehabilitated building *or qualified revitalization building (respectively)*, then the tax under this chapter for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted solely from reducing to zero the credit determined under this subpart with respect to such building.

(B) CERTAIN EXCESS CREDIT RECAPTURED.—Any amount which would have been applied as a reduction under paragraph (2) of section 47(b) but for the fact that a reduction under such paragraph cannot reduce the amount taken into account under section 47(b)(1) below zero shall be treated as an amount required to be recaptured under subparagraph (A) for the taxable year during which the building is placed in service. *A similar rule shall apply for purposes of section 1400K.*

(C) CERTAIN SALES AND LEASEBACKS.—Under regulations prescribed by the Secretary, a sale by, and leaseback to, a taxpayer who, when the property is placed in service, will be a lessee to whom the rules referred to in subsection (d)(5) apply shall not be treated as a cessation described in subparagraph (A) to the extent that the amount which will be passed through to the lessee under such rules with respect to such property is not less than the qualified rehabilitation expenditures properly taken into account by the lessee under section 47(d) *or 1400K(d)(2)* with respect to such property.

(D) COORDINATION WITH PARAGRAPH (1).—If, after property is placed in service, there is a disposition or other cessation described in paragraph (1), then paragraph (1) shall be applied as if any credit which was allowable by reason of section 47(d) *or 1400K(d)(2)* and which has not been required to be recaptured before such disposition, cessation, or change in use were allowable for the taxable year the property was placed in service.

(E) SPECIAL RULES.—Rules similar to the rules of this paragraph shall apply in cases where qualified progress expenditures were taken into account under the rules referred to in section 48(a)(5).

* * * * * * *

(b) CERTAIN PROPERTY NOT ELIGIBLE.—No credit shall be determined under this subpart with respect to—

(1) * * *

(2) PROPERTY USED FOR LODGING.—No credit shall be determined under this subpart with respect to any property which is used predominantly to furnish lodging or in connection with the furnishing of lodging. The preceding sentence shall not apply to—

(A) * * *

* * * * * * *

(C) a certified historic structure to the extent of that portion of the basis which is attributable to qualified rehabilitation expenditures; [and]

(D) any energy property[.]*; and*

(E) a qualified revitalization building (as defined in section 1400K) to the extent of the portion of the basis which is attributable to qualified revitalization expenditures (as defined in section 1400K).

(3) PROPERTY USED BY CERTAIN TAX-EXEMPT ORGANIZATIONS.—No credit shall be determined under this subpart with respect to any property used by an organization (other than a cooperative described in section 521 which is exempt from the tax imposed by this chapter unless such property is used predominantly in an unrelated trade or business the income of

which is subject to tax under section 511. If the property is debt-financed property (as defined in section 514(b), the amount taken into account for purposes of determining the amount of the credit under this subpart with respect to such property shall be that percentage of the amount (which but for this paragraph would be so taken into account) which is the same percentage as is used under section 514(a), for the year the property is placed in service, in computing the amount of gross income to be taken into account during such taxable year with respect to such property. [If any qualified rehabilitated building is used by the tax-exempt organization pursuant to a lease, this paragraph shall not apply for purposes of determining the amount of the rehabilitation credit.] *If any qualified rehabilitated building or qualified revitalization building is used by the tax-exempt organization pursuant to a lease, this paragraph shall not apply for purposes of determining the amount of the rehabilitation credit or the commercial revitalization credit.*

(4) PROPERTY USED BY GOVERNMENTAL UNITS OR FOREIGN PERSONS OR ENTITIES.—

(A) * * *

* * * * * * *

(C) EXCEPTION FOR QUALIFIED REHABILITATED *OR COMMERCIAL REVITALIZATION* BUILDINGS LEASED TO GOVERNMENTS, ETC.—If any qualified rehabilitated *or commercial revitalization* building is leased to a governmental unit (or a foreign person or entity) this paragraph shall not apply for purposes of determining the rehabilitation *or commercial revitalization* credit with respect to such building.

* * * * * * *

Subpart F—Rules for Computing Work Opportunity Credit

* * * * * * *

SEC. 51. AMOUNT OF CREDIT.

(a) * * *

* * * * * * *

(c) WAGES DEFINED.—For purposes of this subpart—

(1) * * *

* * * * * * *

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

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

(B) after [June 30, 1998] *February 29, 2000*.

(5) EXTENSION OF CREDIT FOR RENEWAL COMMUNITIES.—

(A) IN GENERAL.—In the case of an individual who begins work for the employer after the date contained in paragraph (4)(B), for purposes of section 38—

(i) in lieu of applying subsection (a), the amount of the work opportunity credit determined under this section for the taxable year shall be equal to—

(I) 15 percent of the qualified first-year wages for such year, and

(II) 30 percent of the qualified second-year wages for such year,

(ii) subsection (b)(3) shall be applied by substituting "$10,000" for "$6,000",

(iii) paragraph (4)(B) shall be applied by substituting for the date contained therein the last day for which the designation under section 1400E of the renewal community referred to in subparagraph (B)(i) is in effect, and

(iv) rules similar to the rules of section 51A(b)(5)(C) shall apply.

(B) QUALIFIED FIRST AND SECOND-YEAR WAGES.—For purposes of subparagraph (A)—

(i) IN GENERAL.—The term "qualified wages" means, with respect to each 1-year period referred to in clause (ii) or (iii), as the case may be, the wages paid or incurred by the employer during the taxable year to any individual but only if—

(I) the employer is engaged in a trade or business in a renewal community throughout such 1-year period,

(II) the individual is a resident of such renewal community throughout such 1-year period, and

(III) substantially all of the services which such individual performs for the employer during such 1-year period are performed in such renewal community.

(ii) 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.

(iii) 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 clause (ii).

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

(1) * * *

* * * * * * *

(5) HIGH-RISK YOUTH.—

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

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

(ii) as having his principal place of abode within an [empowerment zone or enterprise community] *empowerment zone, enterprise community, or renewal community*.

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

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

(A) * * *

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

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

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

(7) QUALIFIED SUMMER YOUTH EMPLOYEE.—

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

(i) * * *

* * * * * * *

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

* * * * * * *

(C) YOUTH MUST CONTINUE TO RESIDE IN ZONE *OR COMMUNITY*.—Paragraph (5)(B) shall apply for purposes of subparagraph (A)(iv).

* * * * * * *

SEC. 51A. TEMPORARY INCENTIVES FOR EMPLOYING LONG-TERM FAMILY ASSISTANCE RECIPIENTS.

(a) * * *

* * * * * * *

(f) TERMINATION.—This section shall not apply to individuals who begin work for the employer after [April 30, 1999] *February 29, 2000*.

* * * * * * *

Subchapter B—Computation of Taxable Income

* * * * * * *

PART I—DEFINITION OF GROSS INCOME, ADJUSTED GROSS INCOME, TAXABLE INCOME, ETC.

* * * * * * *

SEC. 62. ADJUSTED GROSS INCOME DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "adjusted gross income" means, in the case of an individual, gross income minus the following deductions:

(1) * * *

* * * * * * *

(18) FAMILY DEVELOPMENT ACCOUNTS.—The deduction allowed by section 1400H(a)(1)(A).

* * * * * * *

SEC. 63. TAXABLE INCOME DEFINED.

(a) * * *

* * * * * * *

(c) STANDARD DEDUCTION.—For purposes of this subtitle—

(1) * * *

(2) BASIC STANDARD DEDUCTION.—For purposes of paragraph (1), the basic standard deduction is—

(A) ❲$5,000❳ *twice the dollar amount in effect under subparagraph (C) for the taxable year* in the case of—

(i) a joint return, or

(ii) a surviving spouse (as defined in section 2(a)),

(B) $4,400 in the case of a head of household (as defined in section 2(b)), *or*

(C) $3,000 ❲in the case of an individual who is not married and who is not a surviving spouse or head of household, or❳ *in any other case.*

❲(D) $2,500 in the case of a married individual filing a separate return.❳

* * * * * * *

(4) ADJUSTMENTS FOR INFLATION.—In the case of any taxable year beginning in a calendar year after 1988, each dollar amount contained in paragraph (2) or (5) or subsection (f) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) 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).

The preceding sentence shall not apply to the amount referred to in paragraph (2)(A).

* * * * * * *

(f) AGED OR BLIND ADDITIONAL AMOUNTS.—

(1) ADDITIONAL AMOUNTS FOR THE AGED.—The taxpayer shall be entitled to an additional amount of ❲$600❳ *$750*—

(A) for himself if he has attained age 65 before the close of his taxable year, and

(B) for the spouse of the taxpayer if the spouse has attained age 65 before the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

(2) ADDITIONAL AMOUNT FOR BLIND.—The taxpayer shall be entitled to an additional amount of ❲$600❳ *$750*—

(A) for himself if he is blind at the close of the taxable year, and

(B) for the spouse of the taxpayer if the spouse is blind as of the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

For purposes of subparagraph (B), if the spouse dies during the taxable year the determination of whether such spouse is blind shall be made as of the time of such death.

❲(3) HIGHER AMOUNT FOR CERTAIN UNMARRIED INDIVIDUALS.—In the case of an individual who is not married and is not a surviving spouse, paragraphs (1) and (2) shall be applied by substituting "$750" for "$600".❳

❲(4)❳ *(3)* BLINDNESS DEFINED.—For purposes of this subsection, an individual is blind only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

* * * * * * *

SEC. 67. 2-PERCENT FLOOR ON MISCELLANEOUS ITEMIZED DEDUCTIONS.

(a) * * *

(b) MISCELLANEOUS ITEMIZED DEDUCTIONS.—For purposes of this section, the term "miscellaneous itemized deductions" means the itemized deductions other than—

(1) * * *

* * * * * * *

(3) the deduction under section 165(a) ❲for losses described in subsection (c)(3) or (d) of section 165❳ *for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d)*,

* * * * * * *

SEC. 68. OVERALL LIMITATION ON ITEMIZED DEDUCTIONS.

(a) * * *

* * * * * * *

(c) EXCEPTION FOR CERTAIN ITEMIZED DEDUCTIONS.—For purposes of this section, the term "itemized deductions" does not include—

(1) * * *

* * * * * * *

(3) the deduction under section 165(a) [for losses described in subsection (c)(3) or (d) of section 165] *for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d)*.

* * * * * * *

PART II—ITEMS SPECIFICALLY INCLUDED IN GROSS INCOME

* * * * * * *

SEC. 72. ANNUITIES; CERTAIN PROCEEDS OF ENDOWMENT AND LIFE INSURANCE CONTRACTS.

(a) * * *

* * * * * * *

(e) AMOUNTS NOT RECEIVED AS ANNUITIES.—

(1) * * *

* * * * * * *

(9) EXTENSION OF PARAGRAPH (2)(B) TO QUALIFIED [STATE] TUITION PROGRAMS AND EDUCATIONAL INDIVIDUAL RETIREMENT ACCOUNTS.—Notwithstanding any other provision of this subsection, paragraph (2)(B) shall apply to amounts received under a [qualified State tuition program] *qualified tuition program* (as defined in section 529(b)) or under an education individual retirement account (as defined in section 530(b)). The rule of paragraph (8)(B) shall apply for purposes of this paragraph.

* * * * * * *

PART III—ITEMS SPECIFICALLY EXCLUDED FROM GROSS INCOME

Sec. 101. Certain death benefits.

* * * * * * *

Sec. 116. Partial exclusion of dividends and interest received by individuals.

* * * * * * *

SEC. 116. PARTIAL EXCLUSION OF DIVIDENDS AND INTEREST RECEIVED BY INDIVIDUALS.

(a) EXCLUSION FROM GROSS INCOME.—Gross income does not include dividends and interest received during the taxable year by an individual.

(b) LIMITATIONS.—

(1) MAXIMUM AMOUNT.—The aggregate amount excluded under subsection (a) for any taxable year shall not exceed $200 ($400 in the case of a joint return).

(2) CERTAIN DIVIDENDS EXCLUDED.—Subsection (a) shall not apply to any dividend from a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is a corporation exempt from tax under section 501 (relating to certain charitable, etc., organization) or section 521 (relating to farmers' cooperative associations).

(c) SPECIAL RULES.—For purposes of this section—

(1) EXCLUSION NOT TO APPLY TO CAPITAL GAIN DIVIDENDS FROM REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

For treatment of capital gain dividends, see sections 854(a) and 857(c).

(2) CERTAIN NONRESIDENT ALIENS INELIGIBLE FOR EXCLUSION.—In the case of a nonresident alien individual, subsection (a) shall apply only—

(A) in determining the tax imposed for the taxable year pursuant to section 871(b)(1) and only in respect of dividends and interest which are effectively connected with the conduct of a trade or business within the United States, or

(B) in determining the tax imposed for the taxable year pursuant to section 877(b).

(3) DIVIDENDS FROM EMPLOYEE STOCK OWNERSHIP PLANS.—Subsection (a) shall not apply to any dividend described in section 404(k).

* * * * * * *

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

(a) * * *

* * * * * * *

(d) SPECIAL RULES.—

(1) * * *

* * * * * * *

(9) MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE.—

(A) IN GENERAL.—The running of the 5-year period described in subsection (a) shall be suspended with respect to an individual during any time that such individual or such individual's spouse is serving on qualified official extended duty as a member of the uniformed services or of the Foreign Service.

(B) QUALIFIED OFFICIAL EXTENDED DUTY.—For purposes of this paragraph—

(i) IN GENERAL.—The term "qualified official extended duty" means any period of extended duty as a member of the uniformed services or a member of the Foreign Service during which the member serves at a duty station which is at least 50 miles from such property or is under Government orders to reside in Government quarters.

(ii) UNIFORMED SERVICES.—The term "uniformed services" has the meaning given such term by section 101(a)(5) of title 10, United States Code, as in effect on the date of the enactment of this paragraph.

(iii) FOREIGN SERVICE OF THE UNITED STATES.—The term "member of the Foreign Service" has the meaning given the term "member of the Service" by paragraph (1), (2), (3), (4), or (5) of section 103 of the Foreign Service Act of 1980, as in effect on the date of the enactment of this paragraph.

(iv) EXTENDED DUTY.—The term "extended 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.

* * * * * * *

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

(a) * * *

* * * * * * *

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

(1) * * *

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) * * *

(B) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC.—Such term shall not include expenses with respect to any course or other education involving sports, games, or hobbies other than as part of a degree program.

(C) CONTRIBUTIONS TO [QUALIFIED STATE TUITION PROGRAM] *QUALIFIED TUITION PROGRAMS* AND EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—Such term shall include any contribution to a [qualified State tuition program] *qualified tuition program* (as defined in section 529 on behalf of a designated beneficiary (as defined in such section), or to an education individual retirement account (as defined in section 530 on behalf of an account beneficiary, 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 72 by reason of any portion of such contribution which is not includible in gross income by reason of this subparagraph.

* * * * * * *

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

(A) without regard to this section and sections *116,* 137, 911, 931, and 933, and

(B) after the application of sections 86, 469, and 219.

(d) SPECIAL RULES.—

(1) ADJUSTMENT FOR CERTAIN SCHOLARSHIPS AND VETERANS BENEFITS.—The amount of 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 sum of the amounts received with respect to such individual for the taxable year as—

(A) * * *

* * * * * * *

(D) a payment, waiver, or reimbursement of qualified higher education expenses under a [qualified State tuition program] *qualified tuition program* (within the meaning of section 529(b).

* * * * * * *

(4) COORDINATION WITH SECTION 116.—This section shall be applied before section 116.

【(4)】 *(5)* REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations requiring record keeping and information reporting.

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PART IV—TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS

* * * * * * *

Subpart A—Private Activity Bonds

* * * * * * *

SEC. 146. VOLUME CAP.

(a) * * *

* * * * * * *

(d) STATE CEILING.—For purposes of this section—

【(1) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of—

【(A) an amount equal to $75 multiplied by the State population, or

【(B) $250,000,000.

Subparagraph (B) shall not apply to any possession of the United States.

【(2) ADJUSTMENT AFTER 1987.—In the case of calendar years after 1987, paragraph (1) shall be applied by substituting—

【(A) "$50" for "$75", and

【(B) "$150,000,000" for "$250,000,000".】

(1) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of—

(A) an amount equal to $75 multiplied by the State population, or

(B) $225,000,000.

Subparagraph (B) shall not apply to any possession of the United States.

【(3)】 *(2)* SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—For purposes of this section—

(A) * * *

* * * * * * *

【(4)】 *(3)* SPECIAL RULE FOR POSSESSIONS WITH POPULATIONS OF LESS THAN THE POPULATION OF THE LEAST POPULOUS STATE.—

(A) * * *

* * * * * * *

Subpart B—Requirements Applicable to All State and Local Bonds

* * * * * * *

SEC. 148. ARBITRAGE.

(a) * * *

* * * * * * *

(f) REQUIRED REBATE TO THE UNITED STATES.—

(1) * * *

* * * * * * *

(4) SPECIAL RULES FOR APPLYING PARAGRAPH (2).—

(A) * * *

* * * * * * *

(C) EXCEPTION FROM REBATE FOR CERTAIN PROCEEDS TO BE USED TO FINANCE CONSTRUCTION EXPENDITURES.—

(i) * * *

* * * * * * *

(xviii) 4-YEAR SPENDING REQUIREMENT FOR PUBLIC SCHOOL CONSTRUCTION ISSUE.—

(I) IN GENERAL.—In the case of a public school construction issue, the spending requirements of clause (ii) shall be treated as met if at least 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued, 30 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date, 50 percent of such proceeds are spent for such purposes within the 3-year period beginning on such date, and 100 percent of such proceeds are spent for such purposes within the 4-year period beginning on such date.

(II) PUBLIC SCHOOL CONSTRUCTION ISSUE.—For purposes of this clause, the term "public school construction issue" means any construction issue if no bond which is part of such issue is a private activity bond and all of the available construction proceeds of such issue are to be used for the construction (as defined in clause (iv)) of public school facilities to provide education or training below the postsecondary level or for the acquisition of land that is functionally related and subordinate to such facilities.

(III) OTHER RULES TO APPLY.—Rules similar to the rules of the preceding provisions of this subparagraph which apply to clause (ii) also apply to this clause.

* * * * * * *

PART VI—ITEMIZED DEDUCTIONS FOR INDIVIDUALS AND CORPORATIONS

* * * * * * *

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) * * *

* * * * * * *

(l) SPECIAL RULES FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.—

[(1) ALLOWANCE OF DEDUCTION.—

[(A) IN GENERAL.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to the applicable percentage of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

[(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the applicable percentage shall be determined under the following table:

[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.]

(1) ALLOWANCE OF DEDUCTION.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to 100 percent of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

* * * * * * *

SEC. 163. INTEREST.

(a) * * *

* * * * * * *

(h) DISALLOWANCE OF DEDUCTION FOR PERSONAL INTEREST.—

(1) * * *

(2) PERSONAL INTEREST.—For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than—

(A) * * *

* * * * * * *

(D) any qualified residence interest (within the meaning of paragraph (3)), [and]

(E) 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 6163[.]*, and*

(F) any interest allowable as a deduction under section 221 (relating to interest on educational loans).

* * * * * * *

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

(a) * * *

* * * * * * *

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

(1) * * *

* * * * * * *

(5) SPECIAL RULE FOR CONTRIBUTIONS OF STOCK FOR WHICH MARKET QUOTATIONS ARE READILY AVAILABLE.—

(A) * * *

* * * * * * *

⟦(D) TERMINATION.—This paragraph shall not apply to contributions made—

⟦(i) after December 31, 1994, and before July 1, 1996, or

⟦(ii) after June 30, 1998.⟧

* * * * * * *

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) * * *

(b) NET OPERATING CARRYBACKS AND CARRYOVERS.—

(1) YEARS TO WHICH LOSS MAY BE CARRIED.—

(A) * * *

* * * * * * *

(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) * * *

* * * * * * *

Such term shall not include any farming loss (as defined in subsection (i)).

* * * * * * *

(iv) COORDINATION WITH PARAGRAPH (2).—For purposes of applying paragraph (2), an eligible loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

(G) FARMING LOSSES.—In the case of a taxpayer which has a farming loss (as defined in subsection (i)) for a taxable year, such farming loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.

* * * * * * *

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

(1) * * *

* * * * * * *

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

(A) * * *

* * * * * * *

[(C) any deduction allowable under section 165(c)(3) (relating to casualty losses) shall not be taken into account; and]

(C) any deduction for casualty or theft losses allowable under paragraph (2) or (3) of section 165(c) shall be treated as attributable to the trade or business; and

* * * * * * *

(i) RULES RELATING TO FARMING LOSSES.—For purposes of this section—

(1) IN GENERAL.—The term "farming loss" means the lesser of—

(A) the amount which would be the net operating loss for the taxable year if only income and deductions attributable to farming businesses (as defined in section 263A(e)(4)) are taken into account, or

(B) the amount of the net operating loss for such taxable year.

(2) COORDINATION WITH SUBSECTION (B)(2).—For purposes of applying subsection (b)(2), a farming loss for any taxable year shall be treated in a manner similar to the manner in which a specified liability loss is treated.

(3) ELECTION.—Any taxpayer entitled to a 5-year carryback under subsection (b)(1)(G) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(G). Such election shall be made in such manner as may be prescribed by the Secretary and shall be made by the due date (including extensions of time) for filing the taxpayer's return for the taxable year of the net operating loss. Such election, once made for any taxable year, shall be irrevocable for such taxable year.

[(i)] *(j)* CROSS REFERENCES.—

(1) For treatment of net operating loss carryovers in certain corporate acquisitions, see section 381.

(2) For special limitation on net operating loss carryovers in case of a corporate change of ownership, see section 382.

* * * * * * *

SEC. 179. ELECTION TO EXPENSE CERTAIN DEPRECIABLE BUSINESS ASSETS.

(a) * * *

(b) LIMITATIONS.—

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

[If the taxable year begins in:	The applicable amount is:
1997	18,000
1998	18,500
1999	19,000
2000	20,000
2001 or 2002	24,000
2003 or thereafter	25,000]

(1) DOLLAR LIMITATION.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $25,000.

* * * * * * *

PART IX—ITEMS NOT DEDUCTIBLE

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SEC. 264. CERTAIN AMOUNTS PAID IN CONNECTION WITH INSURANCE CONTRACTS.

(a) * * *

* * * * * * *

(f) PRO RATA ALLOCATION OF INTEREST EXPENSE TO POLICY CASH VALUES.—

(1) * * *

* * * * * * *

(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.

If the amount described in subparagraph (A) with respect to any policy or contract does not reasonably approximate its actual value, the amount taken into account under subparagraph (A) shall be the greater of the amount of the insurance company liability or the insurance company reserve with respect to such policy or contract (as determined for purposes of the annual statement approved by the National Association of Insurance Commissioners) or shall be such other amount as is determined by the Secretary.

* * * * * * *

SEC. 265. EXPENSES AND INTEREST RELATING TO TAX-EXEMPT INCOME.

(a) GENERAL RULE.—No deduction shall be allowed for—

(1) * * *

(2) INTEREST.—Interest on indebtedness incurred or continued to purchase or carry obligations the interest on which is wholly exempt from the taxes imposed by this subtitle*, or to*

purchase or carry obligations or shares, or to make deposits, to the extent the interest thereon is excludable from gross income under section 116.

* * * * * * *

Subchapter C—Corporate Distributions and Adjustments

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PART II—CORPORATE LIQUIDATIONS

* * * * * * *

Subpart A—Effects on Recipients

* * * * * * *

SEC. 332. COMPLETE LIQUIDATIONS OF SUBSIDIARIES.

(a) * * *

(b) LIQUIDATIONS TO WHICH SECTION APPLIES.—For purposes of ⟦subsection (a)⟧ *this section*, a distribution shall be considered to be in complete liquidation only if—

(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) meeting the requirements of section 1504(a)(2); and either

* * * * * * *

(c) DEDUCTIBLE LIQUIDATING DISTRIBUTIONS OF REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—If a corporation receives a distribution from a regulated investment company or a real estate investment trust which is considered under subsection (b) as being in complete liquidation of such company or trust, then, notwithstanding any other provision of this chapter, such corporation shall recognize and treat as a dividend from such company or trust an amount equal to the deduction for dividends paid allowable to such company or trust by reason of such distribution.

* * * * * * *

SEC. 334. BASIS OF PROPERTY RECEIVED IN LIQUIDATIONS.

(a) * * *

(b) LIQUIDATION OF SUBSIDIARY.—

(1) IN GENERAL.—If property is received by a corporate distributee in a distribution in a complete liquidation to which ⟦section 332(a)⟧ *section 332* applies (or in a transfer described in section 337(b)(1)), the basis of such property in the hands of such distributee shall be the same as it would be in the hands of the transferor; except that, in any case in which gain or loss is recognized by the liquidating corporation with respect to such property, the basis of such property in the hands of

such distributee shall be the fair market value of the property at the time of the distribution.

* * * * * * *

PART III—CORPORATE ORGANIZATIONS AND REORGANIZATIONS

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Subpart A—Corporate Organizations

* * * * * * *

SEC. 351. TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.

(a) * * *

* * * * * * *

(c) SPECIAL RULES WHERE DISTRIBUTION TO SHAREHOLDERS.—

(1) * * *

(2) SPECIAL RULE FOR SECTION 355.—If the requirements of section 355 (or so much of section 356 as relates to section 355) are met with respect to a distribution described in paragraph (1), then, solely for purposes of determining the tax treatment of the transfers of property to the controlled corporation by the distributing corporation, the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock*, or the fact that the corporation whose stock was distributed issues additional stock,* shall not be taken into account in determining control for purposes of this section.

* * * * * * *

Subpart D—Special Rule; Definitions

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SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) * * *

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

(A) * * *

* * * * * * *

(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 (or so much of section 356 as relates to section 355) are met, the fact that the shareholders of the distributing corporation dispose of part or all of the distributed stock*, or the fact* *that the corporation whose stock was distributed issues additional stock,* shall not be taken into account.

* * * * * * *

Subchapter E—Accounting Periods and Methods of Accounting

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PART II—METHODS OF ACCOUNTING

* * * * * * *

Subpart C—Taxable Year for Which Deductions Taken

* * * * * * *

SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

(a) * * *

* * * * * * *

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

(1) * * *

* * * * * * *

(3) PHASE-OUT OF EXEMPTION.—

(A) * * *

* * * * * * *

(C) EXCEPTION FOR LOW-INCOME HOUSING [CREDIT] *AND COMMERCIAL REVITALIZATION CREDITS*.—Subparagraph (A) shall not apply to any portion of the passive activity credit for any taxable year which is attributable to any credit determined under section 42 *or section 1400K*.

* * * * * * *

Subchapter F—Exempt Organizations

* * * * * * *

PART VIII—HIGHER EDUCATION SAVINGS ENTITIES

Sec. 529. Qualified [State] tuition programs.

* * * * * * *

[SEC. 529. QUALIFIED STATE TUITION PROGRAMS.]

SEC. 529. QUALIFIED TUITION PROGRAMS.

(a) GENERAL RULE.—A [qualified State tuition program] *qualified tuition program* shall be exempt from taxation under this subtitle. Notwithstanding the preceding sentence, such program shall be subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable organizations).

(b) QUALIFIED STATE TUITION PROGRAM.—For purposes of this section—

(1) IN GENERAL.—The term "[qualified State tuition program] *qualified tuition program*" means a program established

and maintained by a State or agency or instrumentality thereof *or by 1 or more eligible educational institutions—*

(A) * * *

* * * * * * *

(2) CASH CONTRIBUTIONS.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* unless it provides that purchases or contributions may only be made in cash.

(3) REFUNDS.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* unless it imposes a more than de minimis penalty on any refund of earnings from the account which are not—

(A) used for qualified higher education expenses of the designated beneficiary,

(B) made on account of the death or disability of the designated beneficiary, or

(C) made on account of a scholarship (or allowance or payment described in section 135(d)(1)(B) or (C)) received by the designated beneficiary to the extent the amount of the refund does not exceed the amount of the scholarship, allowance, or payment.

(4) SEPARATE ACCOUNTING.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* unless it provides separate accounting for each designated beneficiary.

(5) NO INVESTMENT DIRECTION.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* unless it provides that any contributor to, or designated beneficiary under, such program may not directly or indirectly direct the investment of any contributions to the program (or any earnings thereon).

(6) NO PLEDGING OF INTEREST AS SECURITY.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* if it allows any interest in the program or any portion thereof to be used as security for a loan.

(7) PROHIBITION ON EXCESS CONTRIBUTIONS.—A program shall not be treated as a [qualified State tuition program] *qualified tuition program* unless it provides 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.

(c) TAX TREATMENT OF DESIGNATED BENEFICIARIES AND CONTRIBUTORS.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, no amount shall be includible in gross income of—

(A) a designated beneficiary under a [qualified State tuition program] *qualified tuition program*, or

(B) a contributor to such program on behalf of a designated beneficiary,

with respect to any distribution or earnings under such program.

(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.

(3) DISTRIBUTIONS.—

(A) IN GENERAL.—Any distribution under a [qualified State tuition program] *qualified tuition program* shall be includible in the gross income of the distributee in the manner as provided under section 72 to the extent not excluded from gross income under any other provision of this chapter.

(B) IN-KIND DISTRIBUTIONS.—Any benefit furnished to a designated beneficiary under a [qualified State tuition program] *qualified tuition program* shall be treated as a distribution to the beneficiary.

(C) CHANGE IN BENEFICIARIES.—

(i) ROLLOVERS.—Subparagraph (A) shall not apply to that portion of any distribution which, within 60 days of such distribution, is transferred to the credit of another designated beneficiary under a [qualified State tuition program] *qualified tuition program* who is a member of the family of the designated beneficiary with respect to which the distribution was made.

(ii) CHANGE IN DESIGNATED BENEFICIARIES.—Any change in the designated beneficiary of an interest in a [qualified State tuition program] *qualified tuition program* shall not be treated as a distribution for purposes of subparagraph (A) if the new beneficiary is a member of the family of the old beneficiary.

(D) OPERATING RULES.—For purposes of applying section 72—

(i) to the extent provided by the Secretary, all [qualified State tuition programs] *qualified tuition programs* of which an individual is a designated beneficiary shall be treated as one program,

(ii) all distributions during a taxable year shall be treated as one distribution, and

(iii) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year in which the taxable year begins.

* * * * * * *

(d) REPORTS.—Each officer or employee having control of the [qualified State tuition program] *qualified 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.

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

(1) DESIGNATED BENEFICIARY.—The term "designated beneficiary" means—

(A) the individual designated at the commencement of participation in the [qualified State tuition program] *qualified tuition program* as the beneficiary of amounts paid (or to be paid) to the program,

(B) in the case of a change in beneficiaries described in subsection (c)(3)(C), the individual who is the new beneficiary, and

(C) in the case of an interest in a qualified [State tuition program] *qualified tuition program* purchased by a State or local government (or agency or instrumentality thereof) or an organization described in section 501(c)(3) and exempt from taxation under section 501(a) as part of a scholarship program operated by such government or organization, the individual receiving such interest as a scholarship.

* * * * * * *

(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) * * *

(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] *qualified 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.

(4) APPLICATION OF SECTION 514.—An interest in a [qualified State tuition program] *qualified tuition program* shall not be treated as debt for purposes of section 514.

(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.

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) * * *

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

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Subchapter H—Banking Institutions

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PART I—RULES OF GENERAL APPLICATION TO BANKING INSTITUTIONS

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SEC. 584. COMMON TRUST FUNDS.

(a) * * *

* * * * * * *

(c) INCOME OF PARTICIPANTS IN FUND.—Each participant in the common trust fund in computing its taxable income shall include, whether or not distributed and whether or not distributable—

(1) * * *

* * * * * * *

The proportionate share of each participant in the amount of dividends or interest received by the common trust fund and to which section 116 applies shall be considered for purposes of such section as having been received by such participant.

* * * * * * *

Subchapter J—Estates, Trusts, Beneficiaries, and Decedents

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PART I—ESTATES, TRUSTS, AND BENEFICIARIES

* * * * * * *

Subpart A—General Rules for Taxation of Estates and Trusts

* * * * * * *

SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) DISTRIBUTABLE NET INCOME.—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) * * *

* * * * * * *

(7) DIVIDENDS OR INTEREST.—There shall be included the amount of any dividends or interest excluded from gross income pursuant to section 116.

⟦(7)⟧ *(8)* ABUSIVE TRANSACTIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations to prevent avoidance of such purposes.

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Subchapter M—Regulated Investment Companies and Real Estate Investment Trusts

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PART II—REAL ESTATE INVESTMENT TRUSTS

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SEC. 854. LIMITATIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANY.

(a) CAPITAL GAIN DIVIDEND.—For purposes of *section 116 (relating to partial exclusion of dividends and interest received by individuals) and* section 243 (relating to deductions for dividends received by corporations), a capital gain dividend (as defined in section 852(b)(3)) received from a regulated investment company shall not be considered as a dividend.

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SEC. 857. TAXATION OF REAL ESTATE INVESTMENT TRUSTS AND THEIR BENEFICIARIES.

(a) * * *

* * * * * * *

⟦(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.]

(c) RESTRICTIONS APPLICABLE TO DIVIDENDS RECEIVED FROM REAL ESTATE INVESTMENT TRUSTS.—

(1) TREATMENT FOR SECTION 116.—For purposes of section 116 (relating to partial exclusion of dividends and interest received by individuals), a capital gain dividend (as defined in subsection (b)(3)(C)) received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

(2) TREATMENT FOR SECTION 243.—For purposes of section 243 (relating to deductions for dividends received by corporations), a dividend received from a real estate investment trust which meets the requirements of this part shall not be considered as a dividend.

* * * * * * *

SEC. 873. DEDUCTIONS.

(a) * * *

(b) EXCEPTIONS.—The following deductions shall be allowed whether or not they are connected with income which is effectively connected with the conduct of a trade or business within the United States:

[(1) LOSSES.—The deduction for losses allowed by section 165(c)(3), but only if the loss is of property located within the United States.]

(1) LOSSES.—The deduction allowed by section 165 for casualty or theft losses described in paragraph (2) or (3) of section 165(c), but only if the loss is of property located within the United States.

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Subchapter N—Tax Bases on Income From Sources Within or Without the United States

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PART III—INCOME FROM SOURCES WITHOUT THE UNITED STATES

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Subpart F—Controlled of Foreign Corporations

* * * * * * *

SEC. 953. INSURANCE INCOME.

[(a) GENERAL RULE.—For purposes of section 952(a)(1), the term "insurance income" means any income which—

[(1) is attributable to the issuing (or reinsuring) of any insurance or annuity contract—

[(A) in connection with property in, liability arising out of activity in, or in connection with the lives or health of residents of, a country other than the country under the laws of which the controlled foreign corporation is created or organized, or

[(B) in connection with risks not described in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract described in subparagraph (A), and

[(2) would (subject to the modifications provided by paragraphs (1) and (2) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.]

(a) INSURANCE INCOME.—

(1) IN GENERAL.—For purposes of section 952(a)(1), the term "insurance income" means any income which—

(A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and

(B) would (subject to the modifications provided by subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company.

(2) EXCEPTION.—Such term shall not include any exempt insurance income (as defined in subsection (e)).

(b) SPECIAL RULES.—For purposes of subsection (a)—

(1) * * *

* * * * * * *

(3) Reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

[(3)] *(4)* All items of income, expenses, losses, and deductions shall be properly allocated or apportioned under regulations prescribed by the Secretary.

* * * * * * *

(e) EXEMPT INSURANCE INCOME.—For purposes of this section—

(1) EXEMPT INSURANCE INCOME DEFINED.—

(A) IN GENERAL.—The term "exempt insurance income" means income derived by a qualifying insurance company which—

(i) is attributable to the issuing (or reinsuring) of an exempt contract by such company or a qualifying insurance company branch of such company, and

(ii) is treated as earned by such company or branch in its home country for purposes of such country's tax laws.

(B) EXCEPTION FOR CERTAIN ARRANGEMENTS.—Such term shall not include income attributable to the issuing (or reinsuring) of an exempt contract as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract which is not an exempt contract.

(C) DETERMINATIONS MADE SEPARATELY.—For purposes of this subsection and section 954(i), the exempt insurance income and exempt contracts of a qualifying insurance

company or any qualifying insurance company branch of such company shall be determined separately for such company and each such branch by taking into account—

(i) in the case of the qualifying insurance company, only items of income, deduction, gain, or loss, and activities of such company not properly allocable or attributable to any qualifying insurance company branch of such company, and

(ii) in the case of a qualifying insurance company branch, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

(2) EXEMPT CONTRACT.—

(A) IN GENERAL.—The term "exempt contract" means an insurance or annuity contract issued or reinsured by a qualifying insurance company or qualifying insurance company branch in connection with property in, liability arising out of activity in, or the lives or health of residents of, a country other than the United States.

(B) MINIMUM HOME COUNTRY INCOME REQUIRED.—

(i) IN GENERAL.—No contract of a qualifying insurance company or of a qualifying insurance company branch shall be treated as an exempt contract unless such company or branch derives more than 30 percent of its net written premiums from exempt contracts (determined without regard to this subparagraph)—

(I) which cover applicable home country risks, and

(II) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)).

(ii) APPLICABLE HOME COUNTRY RISKS.—The term "applicable home country risks" means risks in connection with property in, liability arising out of activity in, or the lives or health of residents of, the home country of the qualifying insurance company or qualifying insurance company branch, as the case may be, issuing or reinsuring the contract covering the risks.

(C) SUBSTANTIAL ACTIVITY REQUIREMENTS FOR CROSS BORDER RISKS.—A contract issued by a qualifying insurance company or qualifying insurance company branch which covers risks other than applicable home country risks (as defined in subparagraph (B)(ii)) shall not be treated as an exempt contract unless such company or branch, as the case may be—

(i) conducts substantial activity with respect to an insurance business in its home country, and

(ii) performs in its home country substantially all of the activities necessary to give rise to the income generated by such contract.

(3) QUALIFYING INSURANCE COMPANY.—The term "qualifying insurance company" means any controlled foreign corporation which—

(A) is subject to regulation as an insurance (or reinsurance) company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country,

(B) derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance by such controlled foreign corporation and each of its qualifying insurance company branches of contracts—

(i) covering applicable home country risks (as defined in paragraph (2)) of such corporation or branch, as the case may be, and

(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)),

except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country's tax laws, and

(C) is engaged in the insurance business and would be subject to tax under subchapter L if it were a domestic corporation.

(4) QUALIFYING INSURANCE COMPANY BRANCH.—The term "qualifying insurance company branch" means a qualified business unit (within the meaning of section 989(a)) of a controlled foreign corporation if—

(A) such unit is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country, and

(B) such controlled foreign corporation is a qualifying insurance company, determined under paragraph (3) as if such unit were a qualifying insurance company branch.

(5) LIFE INSURANCE OR ANNUITY CONTRACT.—For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

(A) such contract is regulated as a life insurance or annuity contract by the corporation's or unit's home country, and

(B) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

(6) HOME COUNTRY.—For purposes of this subsection, except as provided in regulations—

(A) CONTROLLED FOREIGN CORPORATION.—The term "home country" means, with respect to a controlled foreign corporation, the country in which such corporation is created or organized.

(B) QUALIFIED BUSINESS UNIT.—The term "home country" means, with respect to a qualified business unit (as defined in section 989(a)), the country in which the principal office of such unit is located and in which such unit is licensed, authorized, or regulated by the applicable insurance regulatory body to sell insurance, reinsurance, or annuity contracts to persons other than related persons (as defined in section 954(d)(3)) in such country.

(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and section 954(i)—

(A) the rules of section 954(h)(7) (other than subparagraph (B) thereof) shall apply,

(B) there shall be disregarded any item of income, gain, loss, or deduction of, or derived from, an entity which is not engaged in regular and continuous transactions with persons which are not related persons,

(C) there shall be disregarded any change in the method of computing reserves a principal purpose of which is the acceleration or deferral of any item in order to claim the benefits of this subsection or section 954(i),

(D) a contract of insurance or reinsurance shall not be treated as an exempt contract (and premiums from such contract shall not be taken into account for purposes of paragraph (2)(B) or (3)) if—

(i) any policyholder, insured, annuitant, or beneficiary is a resident of the United States and such contract was marketed to such resident and was written to cover a risk outside the United States, or

(ii) the contract covers risks located within and without the United States and the qualifying insurance company or qualifying insurance company branch does not maintain such contemporaneous records, and file such reports, with respect to such contract as the Secretary may require,

(E) the Secretary may prescribe rules for the allocation of contracts (and income from contracts) among 2 or more qualifying insurance company branches of a qualifying insurance company in order to clearly reflect the income of such branches, and

(F) premiums from a contract shall not be taken into account for purposes of paragraph (2)(B) or (3) if such contract reinsures a contract issued or reinsured by a related person (as defined in section 954(d)(3)).

For purposes of subparagraph (D), the determination of where risks are located shall be made under the principles of section 953.

(8) COORDINATION WITH SUBSECTION (c).—In determining insurance income for purposes of subsection (c), exempt insurance income shall not include income derived from exempt contracts which cover risks other than applicable home country risks.

(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and section 954(i).

(10) APPLICATION.—This subsection and section 954(i) shall apply only to the first taxable year of a foreign corporation beginning after December 31, 1998, and before January 1, 2000, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.

(11) CROSS REFERENCE.—

For income exempt from foreign personal holding company income, see section 954(i).

SEC. 954. FOREIGN BASE COMPANY INCOME.

(a) * * *

* * * * * * *

(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—For purposes of subsection (a)(1), the term "foreign personal holding company income" means the portion of the gross income which consists of:

(A) DIVIDENDS, ETC.—Dividends, interest, royalties, rents, and annuities.

(B) CERTAIN PROPERTY TRANSACTIONS.—The excess of gains over losses from the sale or exchange of property—

(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)) *other than property which gives rise to income not treated as foreign personal holding company income by reason of subsection (h) or (i) for the taxable year*,

(ii) which is an interest in a trust, partnership, or REMIC, or

(iii) which does not give rise to any income.

Gains and losses from the sale or exchange of any property which, in the hands of the controlled foreign corporation, is property described in section 1221(1) shall not be taken into account under this subparagraph.

* * * * * * *

(2) EXCEPTION FOR CERTAIN AMOUNTS.—

(A) * * *

* * * * * * *

[(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) EXCEPTION FOR DEALERS.—Except as provided by regulations, in the case of a regular dealer in property which is property described in 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 company income—

(i) any item of income, gain, deduction, or loss (other than any item described in subparagraph (A), (E), or (G) of paragraph (1)) from any transaction (including hedging transactions) entered into in the ordinary course of such dealer's trade or business as such a dealer, and

(ii) if such dealer is a dealer in securities (within the meaning of section 475), any interest or dividend or equivalent amount described in subparagraph (E) or (G) of paragraph (1) from any transaction (including any hedging transaction or transaction described in section 956(c)(2)(J)) entered into in the ordinary course of such dealer's trade or business as such a dealer in securities, but only if the income from the transaction is attributable to activities of the dealer in the country under the laws of which the dealer is created or organized (or in the case of a qualified business unit described in section 989(a), is attributable to activities of the unit in the country in which the unit both maintains its principal office and conducts substantial business activity).

* * * * * * *

(e) FOREIGN BASE COMPANY SERVICES INCOME.—

(1) * * *

(2) EXCEPTION.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange, *or*

(B) an offer or effort to sell or exchange such property**[**, or**]**.

[(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.**]**

Paragraph (1) shall also not apply to income which is exempt insurance income (as defined in section 953(e)) or which is not treated as foreign personal holding income by reason of subsection (c)(2)(C)(ii), (h), or (i).

* * * * * * *

[(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 business, 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 0premiums (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 company 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.]

(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 qualified banking or financing income of an eligible controlled foreign corporation.

(2) ELIGIBLE CONTROLLED FOREIGN CORPORATION.—For purposes of this subsection—

(A) IN GENERAL.—The term "eligible controlled foreign corporation" means a controlled foreign corporation which—

(i) is predominantly engaged in the active conduct of a banking, financing, or similar business, and

(ii) conducts substantial activity with respect to such business.

(B) PREDOMINANTLY ENGAGED.—A controlled foreign corporation shall be treated as predominantly engaged in the active conduct of a banking, financing, or similar business if—

(i) more than 70 percent of the gross income of the controlled foreign corporation is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons,

(ii) it is engaged in the active conduct of a banking business and is an institution licensed to do business as a bank in the United States (or is any other corporation not so licensed which is specified by the Secretary in regulations), or

(iii) it is engaged in the active conduct of a securities business and is registered as a securities broker or dealer under section 15(a) of the Securities Exchange Act of 1934 or is registered as a Government securities broker or dealer under section 15C(a) of such Act (or is any other corporation not so registered which is specified by the Secretary in regulations).

(3) QUALIFIED BANKING OR FINANCING INCOME.—For purposes of this subsection—

(A) IN GENERAL.—The term "qualified banking or financing income" means income of an eligible controlled foreign corporation which—

(i) is derived in the active conduct of a banking, financing, or similar business by—

(I) such eligible controlled foreign corporation, or

(II) a qualified business unit of such eligible controlled foreign corporation,

(ii) is derived from 1 or more transactions—

(I) with customers located in a country other than the United States, and

(II) substantially all of the activities in connection with which are conducted directly by the corporation or unit in its home country, and

(iii) is treated as earned by such corporation or unit in its home country for purposes of such country's tax laws.

(B) LIMITATION ON NONBANKING BUSINESSES.—No income of an eligible controlled foreign corporation not described in clause (ii) or (iii) of paragraph (2)(B) (or of a qualified business unit of such corporation) shall be treated as qualified banking or financing income unless more than 30 percent of such corporation's or unit's gross income is derived directly from the active and regular conduct of a lending or finance business from transactions with customers which are not related persons and which are located within such corporation's or unit's home country.

(C) SUBSTANTIAL ACTIVITY REQUIREMENT FOR CROSS BORDER INCOME.—The term "qualified banking or financing income" shall not include income derived from 1 or more transactions with customers located in a country other than the home country of the eligible controlled foreign corporation or a qualified business unit of such corporation unless such corporation or unit conducts substantial activity with respect to a banking, financing, or similar business in its home country.

(D) DETERMINATIONS MADE SEPARATELY.—For purposes of this paragraph, the qualified banking or financing income of an eligible controlled foreign corporation and each qualified business unit of such corporation shall be determined separately for such corporation and each such unit by taking into account—

(i) in the case of the eligible controlled foreign corporation, only items of income, deduction, gain, or loss and activities of such corporation not properly alloca-

ble or attributable to any qualified business unit of such corporation, and

(ii) in the case of a qualified business unit, only items of income, deduction, gain, or loss and activities properly allocable or attributable to such unit.

(4) LENDING OR FINANCE BUSINESS.—For purposes of this subsection, the term "lending or finance business" means the business of—

(A) making loans,

(B) purchasing or discounting accounts receivable, notes, or installment obligations,

(C) engaging in leasing (including entering into leases and purchasing, servicing, and disposing of leases and leased assets),

(D) issuing letters of credit or providing guarantees,

(E) providing charge and credit card services, or

(F) rendering services or making facilities available in connection with activities described in subparagraphs (A) through (E) carried on by—

(i) the corporation (or qualified business unit) rendering services or making facilities available, or

(ii) another corporation (or qualified business unit of a corporation) which is a member of the same affiliated group (as defined in section 1504, but determined without regard to section 1504(b)(3)).

(5) OTHER DEFINITIONS.—For purposes of this subsection—

(A) CUSTOMER.—The term "customer" means, with respect to any controlled foreign corporation or qualified business unit, any person which has a customer relationship with such corporation or unit and which is acting in its capacity as such.

(B) HOME COUNTRY.—Except as provided in regulations—

(i) CONTROLLED FOREIGN CORPORATION.—The term "home country" means, with respect to any controlled foreign corporation, the country under the laws of which the corporation was created or organized.

(ii) QUALIFIED BUSINESS UNIT.—The term "home country" means, with respect to any qualified business unit, the country in which such unit maintains its principal office.

(C) LOCATED.—The determination of where a customer is located shall be made under rules prescribed by the Secretary.

(D) QUALIFIED BUSINESS UNIT.—The term "qualified business unit" has the meaning given such term by section 989(a).

(E) RELATED PERSON.—The term "related person" has the meaning given such term by subsection (d)(3).

(6) COORDINATION WITH EXCEPTION FOR DEALERS.—Paragraph (1) shall not apply to income described in subsection (c)(2)(C)(ii) of a dealer in securities (within the meaning of section 475) which is an eligible controlled foreign corporation described in paragraph (2)(B)(iii).

(7) ANTI-ABUSE RULES.—For purposes of applying this subsection and subsection (c)(2)(C)(ii)—

(A) 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 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,

(B) there shall be disregarded any item of income, gain, loss, or deduction of an entity which is not engaged in regular and continuous transactions with customers which are not related persons,

(C) there shall be disregarded any item of income, gain, loss, or deduction with respect to any transaction or series of transactions utilizing, or doing business with—

(i) one or more entities in order to satisfy any home country requirement under this subsection, or

(ii) a special purpose entity or arrangement, including a securitization, financing, or similar entity or arrangement,

if one of the principal purposes of such transaction or series of transactions is qualifying income or gain for the exclusion under this subsection, and

(D) a related person, an officer, a director, or an employee with respect to any controlled foreign corporation (or qualified business unit) which would otherwise be treated as a customer of such corporation or unit with respect to any transaction shall not be so treated if a principal purpose of such transaction is to satisfy any requirement of this subsection.

(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection, subsection (c)(1)(B)(i), subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2).

(9) APPLICATION.—This subsection, subsection (c)(2)(C)(ii), and the last sentence of subsection (e)(2) shall apply only to the first taxable year of a foreign corporation beginning after December 31, 1998, and before January 1, 2000, and to taxable years of United States shareholders with or within which such taxable year of such foreign corporation ends.

(i) SPECIAL RULE FOR INCOME DERIVED IN THE ACTIVE CONDUCT OF INSURANCE BUSINESS.—

(1) IN GENERAL.—For purposes of subsection (c)(1), foreign personal holding company income shall not include qualified insurance income of a qualifying insurance company.

(2) QUALIFIED INSURANCE INCOME.—The term "qualified insurance income" means income of a qualifying insurance company which is—

(A) 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 or a qualifying insurance company branch of its reserves

allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in the manner prescribed under paragraph (4)), or

(B) 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 or a qualifying insurance company branch of an amount of its assets allocable to exempt contracts equal to—

(i) in the case of 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 life insurance or annuity contracts, 10 percent of the reserves described in subparagraph (A) for such contracts.

(3) PRINCIPLES FOR DETERMINING INSURANCE INCOME.—Except as provided by the Secretary, for purposes of subparagraphs (A) and (B) of paragraph (2)—

(A) in the case of any contract which is a separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract shall be allocable only to such contract, and

(B) income not allocable under subparagraph (A) shall be allocated ratably among contracts not described in subparagraph (A).

(4) METHODS FOR DETERMINING UNEARNED PREMIUMS AND RESERVES.—For purposes of paragraph (2)(A)—

(A) PROPERTY AND CASUALTY CONTRACTS.—The unearned premiums and reserves of a qualifying insurance company or a qualifying insurance company branch 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 or branch were subject to tax under subchapter L, except that—

(i) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate, and

(ii) such company or branch shall use the appropriate foreign loss payment pattern.

(B) LIFE INSURANCE AND ANNUITY CONTRACTS.—The amount of the reserve of a qualifying insurance company or qualifying insurance company branch for any life insurance or annuity contract shall be equal to the greater of—

(i) the net surrender value of such contract (as defined in section 807(e)(1)(A)), or

(ii) the reserve determined under paragraph (5).

(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 de-

termining foreign statement reserves (less any catastrophe, deficiency, equalization, or similar reserves).

(5) AMOUNT OF RESERVE.—The amount of the reserve determined under this paragraph with respect to any contract shall be determined in the same manner as it would be determined if the qualifying insurance company or qualifying insurance company branch were subject to tax under subchapter L, except that in applying such subchapter—

(A) the interest rate determined for the functional currency of the company or branch, and which, except as provided by the Secretary, is calculated in the same manner as the Federal mid-term rate under section 1274(d), shall be substituted for the applicable Federal interest rate,

(B) the highest assumed interest rate permitted to be used in determining foreign statement reserves shall be substituted for the prevailing State assumed interest rate, and

(C) tables for mortality and morbidity which reasonably reflect the current mortality and morbidity risks in the company's or branch's home country shall be substituted for the mortality and morbidity tables otherwise used for such subchapter.

The Secretary may provide that the interest rate and mortality and morbidity tables of a qualifying insurance company may be used for 1 or more of its qualifying insurance company branches when appropriate.

(6) DEFINITIONS.—For purposes of this subsection, any term used in this subsection which is also used in section 953(e) shall have the meaning given such term by section 953.

* * * * * * *

Subchapter X—Renewal Communities

Part I. Designation.
Part II. Renewal community capital gain; renewal community business.
Part III. Family development accounts.
Part IV. Additional incentives.

PART I—DESIGNATION

Sec. 1400E. Designation of renewal communities.

SEC. 1400E. DESIGNATION OF RENEWAL COMMUNITIES.

(a) DESIGNATION.—

(1) DEFINITIONS.—For purposes of this title, the term "renewal community" means any area—

(A) which is nominated by one or more local governments and the State or States in which it is located for designation as a renewal community (hereinafter in this section referred to as a "nominated area"), and

(B) which the Secretary of Housing and Urban Development designates as a renewal community, after consultation with—

(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury; the Director of the Office of Management and Budget; and the Administrator of the Small Business Administration, and

(ii) in the case of an area on an Indian reservation, the Secretary of the Interior.

(2) NUMBER OF DESIGNATIONS.—

(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 20 nominated areas as renewal communities.

(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under paragraph (1), at least 4 must be areas—

(i) which are within a local government jurisdiction or jurisdictions with a population of less than 50,000,

(ii) which are outside of a metropolitan statistical area (within the meaning of section 143(k)(2)(B)), or

(iii) which are determined by the Secretary of Housing and Urban Development, after consultation with the Secretary of Commerce, to be rural areas.

(3) AREAS DESIGNATED BASED ON DEGREE OF POVERTY, ETC.—

(A) IN GENERAL.—Except as otherwise provided in this section, the nominated areas designated as renewal communities under this subsection shall be those nominated areas with the highest average ranking with respect to the criteria described in subparagraphs (B), (C), and (D) of subsection (c)(3). For purposes of the preceding sentence, an area shall be ranked within each such criterion on the basis of the amount by which the area exceeds such criterion, with the area which exceeds such criterion by the greatest amount given the highest ranking.

(B) EXCEPTION WHERE INADEQUATE COURSE OF ACTION, ETC.—An area shall not be designated under subparagraph (A) if the Secretary of Housing and Urban Development determines that the course of action described in subsection (d)(2) with respect to such area is inadequate.

(C) PRIORITY FOR EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES WITH RESPECT TO FIRST HALF OF DESIGNATIONS.— With respect to the first 10 designations made under this section—

(i) 10 shall be chosen from nominated areas which are empowerment zones or enterprise communities (and are otherwise eligible for designation under this section), and

(ii) of such 10, 2 shall be areas described in paragraph (2)(B).

(4) LIMITATION ON DESIGNATIONS.—

(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

(i) the procedures for nominating an area under paragraph (1)(A),

(ii) the parameters relating to the size and population characteristics of a renewal community, and

(iii) the manner in which nominated areas will be evaluated based on the criteria specified in subsection (d).

(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate nominated areas as renewal communities only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

(C) PROCEDURAL RULES.—The Secretary of Housing and Urban Development shall not make any designation of a nominated area as a renewal community under paragraph (2) unless—

(i) the local governments and the States in which the nominated area is located have the authority—

(I) to nominate such area for designation as a renewal community,

(II) to make the State and local commitments described in subsection (d), and

(III) to provide assurances satisfactory to the Secretary of Housing and Urban Development that such commitments will be fulfilled,

(ii) a nomination regarding such area is submitted in such a manner and in such form, and contains such information, as the Secretary of Housing and Urban Development shall by regulation prescribe, and

(iii) the Secretary of Housing and Urban Development determines that any information furnished is reasonably accurate.

(5) NOMINATION PROCESS FOR INDIAN RESERVATIONS.—For purposes of this subchapter, in the case of a nominated area on an Indian reservation, the reservation governing body (as determined by the Secretary of the Interior) shall be treated as being both the State and local governments with respect to such area.

(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—

(1) IN GENERAL.—Any designation of an area as a renewal community shall remain in effect during the period beginning on the date of the designation and ending on the earliest of—

(A) December 31, 2006,

(B) the termination date designated by the State and local governments in their nomination, or

(C) the date the Secretary of Housing and Urban Development revokes such designation.

(2) REVOCATION OF DESIGNATION.—The Secretary of Housing and Urban Development may revoke the designation under this section of an area if such Secretary determines that the local government or the State in which the area is located—

(A) has modified the boundaries of the area, or

(B) is not complying substantially with, or fails to make progress in achieving, the State or local commitments, respectively, described in subsection (d).

(c) AREA AND ELIGIBILITY REQUIREMENTS.—

(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate a nominated area as a renewal community under subsection (a) only if the area meets the requirements of paragraphs (2) and (3) of this subsection.

(2) AREA REQUIREMENTS.—A nominated area meets the requirements of this paragraph if—

(A) the area is within the jurisdiction of one or more local governments,

(B) the boundary of the area is continuous, and

(C) the area—

(i) has a population, of at least—

(I) 4,000 if any portion of such area (other than a rural area described in subsection (a)(2)(B)(i)) is located within a metropolitan statistical area (within the meaning of section 143(k)(2)(B)) which has a population of 50,000 or greater, or

(II) 1,000 in any other case, or

(ii) is entirely within an Indian reservation (as determined by the Secretary of the Interior).

(3) ELIGIBILITY REQUIREMENTS.—A nominated area meets the requirements of this paragraph if the State and the local governments in which it is located certify (and the Secretary of Housing and Urban Development, after such review of supporting data as he deems appropriate, accepts such certification) that—

(A) the area is one of pervasive poverty, unemployment, and general distress,

(B) the unemployment rate in the area, as determined by the most recent available data, was at least 1½ times the national unemployment rate for the period to which such data relate,

(C) the poverty rate for each population census tract within the nominated area is at least 20 percent, and

(D) in the case of an urban area, at least 70 percent of the households living in the area have incomes below 80 percent of the median income of households within the jurisdiction of the local government (determined in the same manner as under section 119(b)(2) of the Housing and Community Development Act of 1974).

(4) CONSIDERATION OF HIGH INCIDENCE OF CRIME.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, the extent to which such areas have a high incidence of crime.

(5) CONSIDERATION OF COMMUNITIES IDENTIFIED IN GAO STUDY.—The Secretary of Housing and Urban Development shall take into account, in selecting nominated areas for designation as renewal communities under this section, if the area has census tracts identified in the May 12, 1998, report of the General Accounting Office regarding the identification of economically distressed areas.

(d) REQUIRED STATE AND LOCAL COMMITMENTS.—

(1) IN GENERAL.—The Secretary of Housing and Urban Development may designate any nominated area as a renewal community under subsection (a) only if—

(A) the local government and the State in which the area is located agree in writing that, during any period during which the area is a renewal community, such governments will follow a specified course of action which meets the requirements of paragraph (2) and is designed to reduce the various burdens borne by employers or employees in such area, and

(B) the economic growth promotion requirements of paragraph (3) are met.

(2) COURSE OF ACTION.—

(A) IN GENERAL.—A course of action meets the requirements of this paragraph if such course of action is a written document, signed by a State (or local government) and neighborhood organizations, which evidences a partnership between such State or government and community-based organizations and which commits each signatory to specific and measurable goals, actions, and timetables. Such course of action shall include at least five of the following:

(i) A reduction of tax rates or fees applying within the renewal community.

(ii) An increase in the level of efficiency of local services within the renewal community.

(iii) Crime reduction strategies, such as crime prevention (including the provision of such services by nongovernmental entities).

(iv) Actions to reduce, remove, simplify, or streamline governmental requirements applying within the renewal community.

(v) Involvement in the program by private entities, organizations, neighborhood organizations, and community groups, particularly those in the renewal community, including a commitment from such private entities to provide jobs and job training for, and technical, financial, or other assistance to, employers, employees, and residents from the renewal community.

(vi) State or local income tax benefits for fees paid for services performed by a nongovernmental entity which were formerly performed by a governmental entity.

(vii) The gift (or sale at below fair market value) of surplus real property (such as land, homes, and commercial or industrial structures) in the renewal community to neighborhood organizations, community development corporations, or private companies.

(B) RECOGNITION OF PAST EFFORTS.—For purposes of this section, in evaluating the course of action agreed to by any State or local government, the Secretary of Housing and Urban Development shall take into account the past efforts of such State or local government in reducing the various burdens borne by employers and employees in the area involved.

(3) ECONOMIC GROWTH PROMOTION REQUIREMENTS.—The economic growth promotion requirements of this paragraph are met with respect to a nominated area if the local government and the State in which such area is located certify in writing that such government and State, respectively, have repealed or otherwise will not enforce within the area, if such area is designated as a renewal community—

(A) licensing requirements for occupations that do not ordinarily require a professional degree,

(B) zoning restrictions on home-based businesses which do not create a public nuisance,

(C) permit requirements for street vendors who do not create a public nuisance,

(D) zoning or other restrictions that impede the formation of schools or child care centers, and

(E) franchises or other restrictions on competition for businesses providing public services, including but not limited to taxicabs, jitneys, cable television, or trash hauling,

except to the extent that such regulation of businesses and occupations is necessary for and well-tailored to the protection of health and safety.

(e) COORDINATION WITH TREATMENT OF EMPOWERMENT ZONES AND ENTERPRISE COMMUNITIES.—For purposes of this title, if there are in effect with respect to the same area both—

(1) a designation as a renewal community, and

(2) a designation as an empowerment zone or enterprise community,

both of such designations shall be given full effect with respect to such area.

(f) DEFINITIONS AND SPECIAL RULES.—For purposes of this subchapter—

(1) GOVERNMENTS.—If more than one government seeks to nominate an area as a renewal community, any reference to, or requirement of, this section shall apply to all such governments.

(2) STATE.—The term "State" includes Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, the Northern Mariana Islands, and any other possession of the United States.

(3) LOCAL GOVERNMENT.—The term "local government" means—

(A) any county, city, town, township, parish, village, or other general purpose political subdivision of a State,

(B) any combination of political subdivisions described in subparagraph (A) recognized by the Secretary of Housing and Urban Development, and

(C) the District of Columbia.

(4) APPLICATION OF RULES RELATING TO CENSUS TRACTS AND CENSUS DATA.—The rules of sections 1392(b)(4) and 1393(a)(9) shall apply.

PART II—RENEWAL COMMUNITY CAPITAL GAIN; RENEWAL COMMUNITY BUSINESS

Sec. 1400F. Renewal community capital gain.
Sec. 1400G. Renewal community business defined.

SEC. 1400F. RENEWAL COMMUNITY CAPITAL GAIN.

(a) GENERAL RULE.—Gross income does not include any qualified capital gain recognized on the sale or exchange of a qualified community asset held for more than 5 years.

(b) QUALIFIED COMMUNITY ASSET.—For purposes of this section—

(1) IN GENERAL.—The term "qualified community asset" means—

(A) any qualified community stock,

(B) any qualified community partnership interest, and

(C) any qualified community business property.

(2) QUALIFIED COMMUNITY STOCK.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the term "qualified community stock" means any stock in a domestic corporation if—

(i) such stock is acquired by the taxpayer after December 31, 1999, and before January 1, 2007, at its original issue (directly or through an underwriter) from the corporation solely in exchange for cash,

(ii) as of the time such stock was issued, such corporation was a renewal community business (or, in the case of a new corporation, such corporation was being organized for purposes of being a renewal community business), and

(iii) during substantially all of the taxpayer's holding period for such stock, such corporation qualified as a renewal community business.

(B) REDEMPTIONS.—A rule similar to the rule of section 1202(c)(3) shall apply for purposes of this paragraph.

(3) QUALIFIED COMMUNITY PARTNERSHIP INTEREST.—The term "qualified community partnership interest" means any interest in a partnership if—

(A) such interest is acquired by the taxpayer after December 31, 1999, and before January 1, 2007,

(B) as of the time such interest was acquired, such partnership was a renewal community business (or, in the case of a new partnership, such partnership was being organized for purposes of being a renewal community business), and

(C) during substantially all of the taxpayer's holding period for such interest, such partnership qualified as a renewal community business.

A rule similar to the rule of paragraph (2)(B) shall apply for purposes of this paragraph.

(4) QUALIFIED COMMUNITY BUSINESS PROPERTY.—

(A) IN GENERAL.—The term "qualified community 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, 1999, and before January 1, 2007,

(ii) the original use of such property in the renewal community 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 renewal community business of the taxpayer.

(B) SPECIAL RULE FOR SUBSTANTIAL IMPROVEMENTS.—The requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as satisfied with respect to—

(i) property which is substantially improved (within the meaning of section 1400B(b)(4)(B)(ii)) by the taxpayer before January 1, 2007, and

(ii) any land on which such property is located.

(c) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (5), (6), and (7) of subsection (b), and subsections (e), (f), and (g), of section 1400B shall apply for purposes of this section.

SEC. 1400G. RENEWAL COMMUNITY BUSINESS DEFINED.

For purposes of this part, the term "renewal community business" means any entity or proprietorship which would be a qualified business entity or qualified proprietorship under section 1397B if—

(1) references to renewal communities were substituted for references to empowerment zones in such section; and

(2) "80 percent" were substituted for "50 percent" in subsections (b)(2) and (c)(1) of such section.

PART III—FAMILY DEVELOPMENT ACCOUNTS

Sec. 1400H. Family development accounts for renewal community EITC recipients.

Sec. 1400I. Demonstration program to provide matching contributions to family development accounts in certain renewal communities.

Sec. 1400J. Designation of earned income tax credit payments for deposit to family development account.

SEC. 1400H. FAMILY DEVELOPMENT ACCOUNTS FOR RENEWAL COMMUNITY EITC RECIPIENTS.

(a) ALLOWANCE OF DEDUCTION.—

(1) IN GENERAL.—There shall be allowed as a deduction—

(A) in the case of a qualified individual, the amount paid in cash for the taxable year by such individual to any family development account for such individual's benefit, and

(B) in the case of any person other than a qualified individual, the amount paid in cash for the taxable year by such person to any family development account for the benefit of a qualified individual but only if the amount so paid is designated for purposes of this section by such individual.

No deduction shall be allowed under this paragraph for any amount deposited in a family development account under section 1400I (relating to demonstration program to provide matching amounts in renewal communities).

(2) LIMITATION.—

(A) IN GENERAL.—The amount allowable as a deduction to any individual for any taxable year by reason of paragraph (1)(A) shall not exceed the lesser of—

(i) $2,000, or

(ii) an amount equal to the compensation includible in the individual's gross income for such taxable year.

(B) PERSONS DONATING TO FAMILY DEVELOPMENT ACCOUNTS OF OTHERS.—The amount which may be designated under paragraph (1)(B) by any qualified individual for any taxable year of such individual shall not exceed $1,000.

(3) SPECIAL RULES FOR CERTAIN MARRIED INDIVIDUALS.—Rules similar to rules of section 219(c) shall apply to the limitation in paragraph (2)(A).

(4) COORDINATION WITH IRA'S.—No deduction shall be allowed under this section to any person by reason of a payment to an account for the benefit of a qualified individual if any amount is paid into an individual retirement account (including a Roth IRA) for the benefit of such individual.

(5) ROLLOVERS.—No deduction shall be allowed under this section with respect to any rollover contribution.

(b) TAX TREATMENT OF DISTRIBUTIONS.—

(1) INCLUSION OF AMOUNTS IN GROSS INCOME.—Except as otherwise provided in this subsection, any amount paid or distributed out of a family development account shall be included in gross income by the payee or distributee, as the case may be.

(2) EXCLUSION OF QUALIFIED FAMILY DEVELOPMENT DISTRIBUTIONS.—Paragraph (1) shall not apply to any qualified family development distribution.

(c) QUALIFIED FAMILY DEVELOPMENT DISTRIBUTION.—For purposes of this section—

(1) IN GENERAL.—The term "qualified family development distribution" means any amount paid or distributed out of a family development account which would otherwise be includible in gross income, to the extent that such payment or distribution is used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder.

(2) QUALIFIED FAMILY DEVELOPMENT EXPENSES.—The term "qualified family development expenses" means any of the following:

(A) Qualified higher education expenses.

(B) Qualified first-time homebuyer costs.

(C) Qualified business capitalization costs.

(D) Qualified medical expenses.

(E) Qualified rollovers.

(3) QUALIFIED HIGHER EDUCATION EXPENSES.—

(A) IN GENERAL.—The term "qualified higher education expenses" has the meaning given such term by section 72(t)(7), determined by treating postsecondary vocational educational schools as eligible educational institutions.

(B) POSTSECONDARY VOCATIONAL EDUCATION SCHOOL.—The term "postsecondary vocational educational school"

means an area vocational education school (as defined in subparagraph (C) or (D) of section 521(4) of the Carl D. Perkins Vocational and Applied Technology Education Act (20 U.S.C. 2471(4))) which is in any State (as defined in section 521(33) of such Act), as such sections are in effect on the date of the enactment of this section.

(C) 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).

(4) QUALIFIED FIRST-TIME HOMEBUYER COSTS.—The term "qualified first-time homebuyer costs" means qualified acquisition costs (as defined in section 72(t)(8) without regard to subparagraph (B) thereof) with respect to a principal residence (within the meaning of section 121) for a qualified first-time homebuyer (as defined in such section).

(5) QUALIFIED BUSINESS CAPITALIZATION COSTS.—

(A) IN GENERAL.—The term "qualified business capitalization costs" means qualified expenditures for the capitalization of a qualified business pursuant to a qualified plan.

(B) QUALIFIED EXPENDITURES.—The term "qualified expenditures" means expenditures included in a qualified plan, including capital, plant, equipment, working capital, and inventory expenses.

(C) QUALIFIED BUSINESS.—The term "qualified business" means any business that does not contravene any law.

(D) QUALIFIED PLAN.—The term "qualified plan" means a business plan which meets such requirements as the Secretary may specify.

(6) QUALIFIED MEDICAL EXPENSES.—The term "qualified medical expenses" means any amount paid during the taxable year, not compensated for by insurance or otherwise, for medical care (as defined in section 213(d)) of the taxpayer, his spouse, or his dependent (as defined in section 152).

(7) QUALIFIED ROLLOVERS.—The term "qualified rollover" means any amount paid from a family development account of a taxpayer into another such account established for the benefit of—

(A) such taxpayer, or

(B) any qualified individual who is—

(i) the spouse of such taxpayer, or

(ii) any dependent (as defined in section 152) of the taxpayer.

Rules similar to the rules of section 408(d)(3) shall apply for purposes of this paragraph.

(d) TAX TREATMENT OF ACCOUNTS.—

(1) IN GENERAL.—Any family development account is exempt from taxation under this subtitle unless such account has ceased to be a family development account by reason of paragraph (2). Notwithstanding the preceding sentence, any such account is subject to the taxes imposed by section 511 (relating to imposition of tax on unrelated business income of charitable, etc., organizations). Notwithstanding any other provision of this title (including chapters 11 and 12), the basis of any person in such an account is zero.

(2) LOSS OF EXEMPTION IN CASE OF PROHIBITED TRANSACTIONS.—For purposes of this section, rules similar to the rules of section 408(e) shall apply.

(3) OTHER RULES TO APPLY.—Rules similar to the rules of paragraphs (4), (5), and (6) of section 408(d) shall apply for purposes of this section.

(e) FAMILY DEVELOPMENT ACCOUNT.—For purposes of this title, the term "family development account" means a trust created or organized in the United States for the exclusive benefit of a qualified individual or his beneficiaries, but only if the written governing instrument creating the trust meets the following requirements:

(1) Except in the case of a qualified rollover (as defined in subsection (c)(7))—

(A) no contribution will be accepted unless it is in cash, and

(B) contributions will not be accepted for the taxable year in excess of $3,000 (determined without regard to any contribution made under section 1400I (relating to demonstration program to provide matching amounts in renewal communities)).

(2) The requirements of paragraphs (2) through (6) of section 408(a) are met.

(f) QUALIFIED INDIVIDUAL.—For purposes of this section, the term "qualified individual" means, for any taxable year, an individual—

(1) who is a bona fide resident of a renewal community throughout the taxable year, and

(2) to whom a credit was allowed under section 32 for the preceding taxable year.

(g) OTHER DEFINITIONS AND SPECIAL RULES.—

(1) COMPENSATION.—The term "compensation" has the meaning given such term by section 219(f)(1).

(2) MARRIED INDIVIDUALS.—The maximum deduction under subsection (a) shall be computed separately for each individual, and this section shall be applied without regard to any community property laws.

(3) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to a family development account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).

(4) EMPLOYER PAYMENTS; CUSTODIAL ACCOUNTS.—Rules similar to the rules of sections 219(f)(5) and 408(h) shall apply for purposes of this section.

(5) REPORTS.—The trustee of a family development account shall make such reports regarding such account to the Secretary and to the individual for whom the account is maintained with respect to contributions (and the years to which they relate), distributions, and such other matters as the Secretary may require under regulations. The reports required by this paragraph—

(A) shall be filed at such time and in such manner as the Secretary prescribes in such regulations, and

(B) shall be furnished to individuals—

(i) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

(ii) in such manner as the Secretary prescribes in such regulations.

(6) INVESTMENT IN COLLECTIBLES TREATED AS DISTRIBUTIONS.—Rules similar to the rules of section 408(m) shall apply for purposes of this section.

(h) PENALTY FOR DISTRIBUTIONS NOT USED FOR QUALIFIED FAMILY DEVELOPMENT EXPENSES.—

(1) IN GENERAL.—If any amount is distributed from a family development account and is not used exclusively to pay qualified family development expenses for the holder of the account or the spouse or dependent (as defined in section 152) of such holder, the tax imposed by this chapter for the taxable year of such distribution shall be increased by the sum of—

(A) 100 percent of the portion of such amount which is includible in gross income and is attributable to amounts contributed under section 1400I (relating to demonstration program to provide matching amounts in renewal communities), and

(B) 10 percent of the portion of such amount which is includible in gross income and is not described in subparagraph (A).

For purposes of this subsection, distributions which are includable in gross income shall be treated as attributable to amounts contributed under section 1400I to the extent thereof. For purposes of the preceding sentence, all family development accounts of an individual shall be treated as one account.

(2) EXCEPTION FOR CERTAIN DISTRIBUTIONS.—Paragraph (1) shall not apply to distributions which are—

(A) made on or after the date on which the account holder attains age 59½,

(B) made to a beneficiary (or the estate of the account holder) on or after the death of the account holder, or

(C) attributable to the account holder's being disabled within the meaning of section 72(m)(7).

(i) TERMINATION.—No deduction shall be allowed under this section for any amount paid to a family development account for any taxable year beginning after December 31, 2006.

SEC. 1400I. DEMONSTRATION PROGRAM TO PROVIDE MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS IN CERTAIN RENEWAL COMMUNITIES.

(a) DESIGNATION.—

(1) DEFINITIONS.—For purposes of this section, the term "FDA matching demonstration area" means any renewal community—

(A) which is nominated under this section by each of the local governments and States which nominated such community for designation as a renewal community under section 1400E(a)(1)(A), and

(B) which the Secretary of Housing and Urban Development designates as an FDA matching demonstration area after consultation with—

(i) the Secretaries of Agriculture, Commerce, Labor, and the Treasury, the Director of the Office of Management and Budget, and the Administrator of the Small Business Administration, and

(ii) in the case of a community on an Indian reservation, the Secretary of the Interior.

(2) NUMBER OF DESIGNATIONS.—

(A) IN GENERAL.—The Secretary of Housing and Urban Development may designate not more than 5 communities as FDA matching demonstration areas.

(B) MINIMUM DESIGNATION IN RURAL AREAS.—Of the areas designated under subparagraph (A), at least 2 must be areas described in section 1400E(a)(2)(B).

(3) LIMITATIONS ON DESIGNATIONS.—

(A) PUBLICATION OF REGULATIONS.—The Secretary of Housing and Urban Development shall prescribe by regulation no later than 4 months after the date of the enactment of this section, after consultation with the officials described in paragraph (1)(B)—

(i) the procedures for nominating a renewal community under paragraph (1)(A) (including procedures for coordinating such nomination with the nomination of an area for designation as a renewal community under section 1400E), and

(ii) the manner in which nominated renewal communities will be evaluated for purposes of this section.

(B) TIME LIMITATIONS.—The Secretary of Housing and Urban Development may designate renewal communities as FDA matching demonstration areas only during the 24-month period beginning on the first day of the first month following the month in which the regulations described in subparagraph (A) are prescribed.

(4) DESIGNATION BASED ON DEGREE OF POVERTY, ETC.—The rules of section 1400E(a)(3) shall apply for purposes of designations of FDA matching demonstration areas under this section.

(b) PERIOD FOR WHICH DESIGNATION IS IN EFFECT.—Any designation of a renewal community as an FDA matching demonstration area shall remain in effect during the period beginning on the date of such designation and ending on the date on which such area ceases to be a renewal community.

(c) MATCHING CONTRIBUTIONS TO FAMILY DEVELOPMENT ACCOUNTS.—

(1) IN GENERAL.—Not less than once each taxable year, the Secretary shall deposit (to the extent provided in appropriation Acts) into a family development account of each qualified individual (as defined in section 1400H(f))—

(A) who is a resident throughout the taxable year of an FDA matching demonstration area, and

(B) who requests (in such form and manner as the Secretary prescribes) such deposit for the taxable year,

an amount equal to the sum of the amounts deposited into all of the family development accounts of such individual during such taxable year (determined without regard to any amount contributed under this section).

(2) LIMITATIONS.—

(A) ANNUAL LIMIT.—The Secretary shall not deposit more than $1000 under paragraph (1) with respect to any individual for any taxable year.

(B) AGGREGATE LIMIT.—The Secretary shall not deposit more than $2000 under paragraph (1) with respect to any individual for all taxable years.

(3) EXCLUSION FROM INCOME.—Except as provided in section 1400H, gross income shall not include any amount deposited into a family development account under paragraph (1).

(d) NOTICE OF PROGRAM.—The Secretary shall provide appropriate notice to residents of FDA matching demonstration areas of the availability of the benefits under this section.

(e) TERMINATION.—No amount may be deposited under this section for any taxable year beginning after December 31, 2006.

SEC. 1400J. DESIGNATION OF EARNED INCOME TAX CREDIT PAYMENTS FOR DEPOSIT TO FAMILY DEVELOPMENT ACCOUNT.

(a) IN GENERAL.—With respect to the return of any qualified individual (as defined in section 1400H(f)) for the taxable year of the tax imposed by this chapter, such individual may designate that a specified portion (not less than $1) of any overpayment of tax for such taxable year which is attributable to the earned income tax credit shall be deposited by the Secretary into a family development account of such individual. The Secretary shall so deposit such portion designated under this subsection.

(b) MANNER AND TIME OF DESIGNATION.—A designation under subsection (a) may be made with respect to any taxable year—

(1) at the time of filing the return of the tax imposed by this chapter for such taxable year, or

(2) at any other time (after the time of filing the return of the tax imposed by this chapter for such taxable year) specified in regulations prescribed by the Secretary.

Such designation shall be made in such manner as the Secretary prescribes by regulations.

(c) PORTION ATTRIBUTABLE TO EARNED INCOME TAX CREDIT.—For purposes of subsection (a), an overpayment for any taxable year shall be treated as attributable to the earned income tax credit to the extent that such overpayment does not exceed the credit allowed to the taxpayer under section 32 for such taxable year.

(d) OVERPAYMENTS TREATED AS REFUNDED.—For purposes of this title, any portion of an overpayment of tax designated under subsection (a) shall be treated as being refunded to the taxpayer as of the last date prescribed for filing the return of tax imposed by this chapter (determined without regard to extensions) or, if later, the date the return is filed.

(e) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2006.

PART IV—ADDITIONAL INCENTIVES

Sec. 1400K. Commercial revitalization credit.
Sec. 1400L. Increase in expensing under section 179.

SEC. 1400K. COMMERCIAL REVITALIZATION CREDIT.

(a) GENERAL RULE.—For purposes of section 46, except as provided in subsection (e), the commercial revitalization credit for any taxable year is an amount equal to the applicable percentage of the qualified revitalization expenditures with respect to any qualified revitalization building.

(b) APPLICABLE PERCENTAGE.—For purposes of this section—

(1) IN GENERAL.—The term "applicable percentage" means—

(A) 20 percent for the taxable year in which a qualified revitalization building is placed in service, or

(B) at the election of the taxpayer, 5 percent for each taxable year in the credit period.

The election under subparagraph (B), once made, shall be irrevocable.

(2) CREDIT PERIOD.—

(A) IN GENERAL.—The term "credit period" means, with respect to any building, the period of 10 taxable years beginning with the taxable year in which the building is placed in service.

(B) APPLICABLE RULES.—Rules similar to the rules under paragraphs (2) and (4) of section 42(f) shall apply.

(c) QUALIFIED REVITALIZATION BUILDINGS AND EXPENDITURES.—For purposes of this section—

(1) QUALIFIED REVITALIZATION BUILDING.—The term "qualified revitalization building" means any building (and its structural components) if—

(A) such building is located in a renewal community and is placed in service after December 31, 1999,

(B) a commercial revitalization credit amount is allocated to the building under subsection (e), and

(C) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building.

(2) QUALIFIED REVITALIZATION EXPENDITURE.—

(A) IN GENERAL.—The term "qualified revitalization expenditure" means any amount properly chargeable to capital account—

(i) for property for which depreciation is allowable under section 168 and which is—

(I) nonresidential real property, or

(II) an addition or improvement to property described in subclause (I), and

(ii) in connection with the construction of any qualified revitalization building which was not previously placed in service or in connection with the substantial rehabilitation (within the meaning of section 47(c)(1)(C)) of a building which was placed in service before the beginning of such rehabilitation.

(B) DOLLAR LIMITATION.—The aggregate amount which may be treated as qualified revitalization expenditures with respect to any qualified revitalization building for any taxable year shall not exceed the excess of—

(i) $10,000,000, reduced by

(ii) any such expenditures with respect to the building taken into account by the taxpayer or any prede-

cessor in determining the amount of the credit under this section for all preceding taxable years.

(C) CERTAIN EXPENDITURES NOT INCLUDED.—The term "qualified revitalization expenditure" does not include—

(i) STRAIGHT LINE DEPRECIATION MUST BE USED.—Any expenditure (other than with respect to land acquisitions) with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1).

(ii) ACQUISITION COSTS.—The costs of acquiring any building or interest therein and any land in connection with such building to the extent that such costs exceed 30 percent of the qualified revitalization expenditures determined without regard to this clause.

(iii) OTHER CREDITS.—Any expenditure which the taxpayer may take into account in computing any other credit allowable under this title unless the taxpayer elects to take the expenditure into account only for purposes of this section.

(d) WHEN EXPENDITURES TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Qualified revitalization expenditures with respect to any qualified revitalization building shall be taken into account for the taxable year in which the qualified revitalization building is placed in service. For purposes of the preceding sentence, a substantial rehabilitation or reconstruction of a building shall be treated as a separate building.

(2) PROGRESS EXPENDITURE PAYMENTS.—Rules similar to the rules of subsections (b)(2) and (d) of section 47 shall apply for purposes of this section.

(e) LIMITATION ON AGGREGATE CREDITS ALLOWABLE WITH RESPECT TO BUILDINGS LOCATED IN A STATE.—

(1) IN GENERAL.—The amount of the credit determined under this section for any taxable year with respect to any building shall not exceed the commercial revitalization credit amount (in the case of an amount determined under subsection (b)(1)(B), the present value of such amount as determined under the rules of section 42(b)(2)(C)) allocated to such building under this subsection by the commercial revitalization credit agency. Such allocation shall be made at the same time and in the same manner as under paragraphs (1) and (7) of section 42(h).

(2) COMMERCIAL REVITALIZATION CREDIT AMOUNT FOR AGENCIES.—

(A) IN GENERAL.—The aggregate commercial revitalization credit amount which a commercial revitalization credit agency may allocate for any calendar year is the amount of the State commercial revitalization credit ceiling determined under this paragraph for such calendar year for such agency.

(B) STATE COMMERCIAL REVITALIZATION CREDIT CEILING.—The State commercial revitalization credit ceiling applicable to any State—

(i) for each calendar year after 1999 and before 2007 is $2,000,000 for each renewal community in the State, and

(ii) zero for each calendar year thereafter.

(C) COMMERCIAL REVITALIZATION CREDIT AGENCY.—For purposes of this section, the term "commercial revitalization credit agency" means any agency authorized by a State to carry out this section.

(f) RESPONSIBILITIES OF COMMERCIAL REVITALIZATION CREDIT AGENCIES.—

(1) PLANS FOR ALLOCATION.—Notwithstanding any other provision of this section, the commercial revitalization credit amount with respect to any building shall be zero unless—

(A) such amount was allocated pursuant to a qualified allocation plan of the commercial revitalization credit agency which is approved (in accordance with rules similar to the rules of section 147(f)(2) (other than subparagraph (B)(ii) thereof)) by the governmental unit of which such agency is a part, and

(B) such agency notifies the chief executive officer (or its equivalent) of the local jurisdiction within which the building is located of such allocation and provides such individual a reasonable opportunity to comment on the allocation.

(2) QUALIFIED ALLOCATION PLAN.—For purposes of this subsection, the term "qualified allocation plan" means any plan—

(A) which sets forth selection criteria to be used to determine priorities of the commercial revitalization credit agency which are appropriate to local conditions,

(B) which considers—

(i) the degree to which a project contributes to the implementation of a strategic plan that is devised for a renewal community through a citizen participation process,

(ii) the amount of any increase in permanent, full-time employment by reason of any project, and

(iii) the active involvement of residents and nonprofit groups within the renewal community, and

(C) which provides a procedure that the agency (or its agent) will follow in monitoring compliance with this section.

(g) TERMINATION.—This section shall not apply to any building placed in service after December 31, 2002.

SEC. 1400L. INCREASE IN EXPENSING UNDER SECTION 179.

(a) GENERAL RULE.—In the case of a renewal community business (as defined in section 1400G), for purposes of section 179—

(1) the limitation under section 179(b)(1) shall be increased by the lesser of—

(A) $35,000, or

(B) the cost of section 179 property which is qualified renewal property placed in service during the taxable year, and

(2) the amount taken into account under section 179(b)(2) with respect to any section 179 property which is qualified renewal property shall be 50 percent of the cost thereof.

(b) RECAPTURE.—Rules similar to the rules under section 179(d)(10) shall apply with respect to any qualified renewal property which ceases to be used in a renewal community by a renewal community business.

(c) QUALIFIED RENEWAL PROPERTY.—For purposes of this section—

(1) IN GENERAL.—The term "qualified renewal property" means any property to which section 168 applies (or would apply but for section 179) if—

(A) such property was acquired by the taxpayer by purchase (as defined in section 179(d)(2)) after December 31, 1999, and before January 1, 2007, and

(B) such property would be qualified zone property (as defined in section 1397C) if references to renewal communities were substituted for references to empowerment zones in section 1397C.

(2) CERTAIN RULES TO APPLY.—The rules of subsections (a)(2) and (b) of section 1397C shall apply for purposes of this section.

Subtitle B—Estate and Gift Taxes

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CHAPTER 11—ESTATE TAX

* * * * * * *

Subchapter A—Estates of Citizens or Residents

* * * * * * *

PART I—TAX IMPOSES

* * * * * * *

SEC. 2001. IMPOSITION AND RATE OF TAX.

(a) * * *

* * * * * * *

(f) VALUATION OF GIFTS.—

(1) * * *

(2) FINAL DETERMINATION.—For purposes of paragraph (1), a value shall be treated as finally determined for purposes of chapter 12 if—

(A) * * *

* * * * * * *

For purposes of subparagraph (A), the value of an item shall be treated as shown on a return if the item is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.

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PART II—CREDITS AGAINST TAX

* * * * * * *

SEC. 2010. UNIFIED CREDIT AGAINST ESTATE TAX.

(a) * * *

* * * * * * *

[(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) APPLICABLE CREDIT AMOUNT.—

(1) IN GENERAL.—For purposes of this section, the applicable credit amount is $345,800.

(2) APPLICABLE EXCLUSION AMOUNT.—For purposes of the provisions of this title which refer to this subsection, the applicable exclusion amount is $1,000,000.

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Subtitle D—Miscellaneous Excise Taxes

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CHAPTER 43—QUALIFIED PENSION, ETC., PLANS

* * * * * * *

SEC. 4973. TAX ON EXCESS CONTRIBUTIONS TO CERTAIN TAX-FAVORED ACCOUNTS AND ANNUITIES.

(a) TAX IMPOSED.—In the case of—

(1) * * *

* * * * * * *

(3) an individual retirement annuity (within the meaning of section 408(b)), a custodial account treated as an annuity contract under section 403(b)(7)(A) (relating to custodial accounts for regulated investment company stock), [or]

(4) an education individual retirement account (as defined in section 530, *or*

(5) a family development account (within the meaning of section 1400H(e)),

there is imposed for each taxable year a tax in an amount equal to 6 percent of the amount of the excess contributions to such individual's accounts or annuities (determined as of the close of the taxable year). The amount of such tax for any taxable year shall not exceed 6 percent of the value of the account or annuity (determined as of the close of the taxable year). In the case of an endowment contract described in section 408(b), the tax imposed by this section does not apply to any amount allocable to life, health, accident, or other insurance under such contract. The tax imposed by this subsection shall be paid by such individual.

* * * * * * *

(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 one beneficiary, the term "excess contributions" means the sum of—

(A) the amount by which the amount contributed for the taxable year to such accounts exceeds $500 (or, if less, the sum of the maximum amounts permitted to be contributed under section 530(c) by the contributors to such accounts for such year);

(B) if any amount is contributed (other than a contribution described in section 530(b)(2)(B)) during such year to a 【qualified State tuition program】 *qualified tuition program* for the benefit of such beneficiary, any amount contributed to such accounts for such taxable year; and

* * * * * * *

(g) FAMILY DEVELOPMENT ACCOUNTS.—For purposes of this section, in the case of a family development account, the term "excess contributions" means the sum of—

(1) the excess (if any) of—

(A) the amount contributed for the taxable year to the account (other than a qualified rollover, as defined in section 1400H(c)(7), or a contribution under section 1400I), over

(B) the amount allowable as a deduction under section 1400H for such contributions, and

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

(A) the distributions out of the account for the taxable year which were included in the gross income of the payee under section 1400H(b)(1),

(B) the distributions out of the account for the taxable year to which rules similar to the rules of section 408(d)(5) apply by reason of section 1400H(b)(3), and

(C) the excess (if any) of the maximum amount allowable as a deduction under section 1400H for the taxable year over the amount contributed to the account for the taxable year (other than a contribution under section 1400I).

For purposes of this subsection, any contribution which is distributed from the family development account in a distribution to which rules similar to the rules of section 408(d)(4) apply by reason of section 1400H(b)(3) shall be treated as an amount not contributed.

* * * * * * *

SEC. 4975. TAX ON PROHIBITED TRANSACTIONS.

(a) * * *

* * * * * * *

(c) PROHIBITED TRANSACTION.—

(1) * * *

* * * * * * *

(6) SPECIAL RULE FOR FAMILY DEVELOPMENT ACCOUNTS.—An individual for whose benefit a family development 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, with respect to such transaction, the account ceases to be a family development account by reason of the application of section 1400H(d)(2) to such account.

* * * * * * *

(e) DEFINITIONS.—

(1) PLAN.—For purposes of this section, the term "plan" means—

(A) * * *

* * * * * * *

(E) an education individual retirement account described in section 530, ⟦or⟧

(F) a family development account described in section 1400H(e), or

⟦(F)⟧ *(G)* a trust, plan, account, or annuity which, at any time, has been determined by the Secretary to be described in any preceding subparagraph of this paragraph.

* * * * * * *

Subtitle F—Procedure and Administration

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CHAPTER 61—INFORMATION AND RETURNS

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Subchapter A—Returns and Records

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PART II—TAX RETURNS OR STATEMENTS

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Subpart B—Income Tax Returns

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SEC. 6015. RELIEF FROM JOINT AND SEVERAL LIABILITY ON JOINT RETURN.

(a) * * *

* * * * * * *

(e) PETITION FOR REVIEW BY TAX COURT.—

(1) * * *

* * * * * * *

(3) APPLICABLE RULES.—

(A) ALLOWANCE OF CREDIT OR REFUND.—Except as provided in subparagraph (B), notwithstanding any other law or rule of law (other than section 6512(b), 7121, or 7122), credit or refund shall be allowed or made to the extent attributable to the application ⟦of this section⟧ *of subsection (b) or (f)*.

* * * * * * *

PART III—INFORMATION RETURNS

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Subpart A—General Requirement

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SEC. 6033. RETURNS BY EXEMPT ORGANIZATIONS.

(a) * * *

* * * * * * *

(c) ADDITIONAL PROVISIONS RELATING TO PRIVATE FOUNDATIONS.—In the case of an organization which is a private foundation (within the meaning of section 509(a))—

(1) the Secretary shall by regulations provide that the private foundation shall include in its annual return under this section such information (not required to be furnished by subsection (b) or the forms or regulations prescribed thereunder) as would have been required to be furnished under section 6056 (relating to annual reports by private foundations) as such section 6056 was in effect on January 1, 1979, *and*

⟦(2) a copy of the notice required by section 6104(d) (relating to public inspection of private foundations' annual returns), together with proof of publication thereof, shall be filed by the foundation together with the annual return under this section, and⟧

⟦(3)⟧ *(2)* the foundation managers shall furnish copies of the annual return under this section to such State officials, at such times, and under such conditions, as the Secretary may by regulations prescribe.

* * * * * * *

SEC. 6047. INFORMATION RELATING TO CERTAIN TRUSTS AND ANNUITY PLANS.

(a) * * *

* * * * * * *

(c) OTHER PROGRAMS.—To the extent provided by regulations prescribed by the Secretary, the provisions of this section apply with respect to any payment described in section 219 *or section 1400H* and to transactions of any trust described in section 408(a)*, of any family development account described in section 1400H(e),* or under an individual retirement annuity described in section 408(b).

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Subchapter B—Extensions of Time For Payment

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SEC. 6103. CONFIDENTIALITY AND DISCLOSURE OF RETURNS AND RETURN INFORMATION.

(a) * * *

* * * * * * *

(h) DISCLOSURE TO CERTAIN FEDERAL OFFICERS AND EMPLOYEES FOR PURPOSES OF TAX ADMINISTRATION, ETC.—

(1) * * *

* * * * * * *

[(5)**]** *(6)* INTERNAL REVENUE SERVICE OVERSIGHT BOARD.—

(A) IN GENERAL.—Notwithstanding paragraph (1), and except as provided in subparagraph (B), no return or return information may be disclosed to any member of the Oversight Board described in subparagraph (A) or (D) of section 7802(b)(1) or to any employee or detailee of such Board by reason of their service with the Board. Any request for information not permitted to be disclosed under the preceding sentence, and any contact relating to a specific taxpayer, made by any such individual to an officer or employee of the Internal Revenue Service shall be reported by such officer or employee to the Secretary, the Treasury Inspector General for Tax Administration, and the Joint Committee on Taxation.

* * * * * * *

(j) STATISTICAL USE.—

(1) * * *

* * * * * * *

(5) DEPARTMENT OF AGRICULTURE.—Upon request in writing by the Secretary of Agriculture, the Secretary shall furnish such returns, or return information reflected thereon, as the Secretary may prescribe by regulation to officers and employees of the Department of Agriculture whose official duties require access to such returns or information for the purpose of, but only to the extent necessary in, structuring, preparing, and conducting the census of agriculture pursuant to the Census of Agriculture Act of 1997 (Public Law 105–113).

* * * * * * *

(p) PROCEDURE AND RECORDKEEPING.—

(1) * * *

* * * * * * *

(3) RECORDS OF INSPECTION AND DISCLOSURE.—

(A) SYSTEM OF RECORDKEEPING.—Except as otherwise provided by this paragraph, the Secretary shall maintain a permanent system of standardized records or accountings of all requests for inspection or disclosure of returns and return information (including the reasons for and dates of such requests) and of returns and return information inspected or disclosed under this section. Notwithstanding the provisions of section 552a(c) of title 5, United States Code, the Secretary shall not be required to maintain a record or accounting of requests for inspection or disclosure of returns and return information, or of returns and return information inspected or disclosed, under the authority of subsections (c), (e), *(f)(5),* (h)(1), (3)(A), or (4), (i)(4), or (7)(A)(ii), (k)(1), (2), (6), (8), or (9) (l)(1), (4)(B), (5), (7), (8), (9), (10), (11), (12), (13), (14), (15), (16), or (17) (m) or (n). The records or accountings required to be maintained under this paragraph shall be available for examination by the Joint Committee on Taxation or the Chief of Staff of such joint committee. Such record or accounting shall also be available for examination by such person or persons as may be, but only to the extent, authorized to make such examination under section 552a(c)(3) of title 5, United States Code.

* * * * * * *

(4) SAFEGUARDS.—Any Federal agency described in subsection (h)(2), (h)(5), (i)(1), (2), (3), or (5), ⟦(j)(1) or (2)⟧ *(j)(1), (2), or (5)*, (k)(8), (l)(1), (2), (3), (5), (11), (13), (14), or (17) or (o)(1), the General Accounting Office, or any agency, body, or commission described in subsection (d), (i)(3)(B)(i) or (l)(6), (7), (8), (9), (10), (12) or (15) shall, as a condition for receiving returns or return information—

(A) * * *

* * * * * * *

(F) upon completion of use of such returns or return information—

(i) * * *

(ii) in the case of an agency described in subsections (h)(2), (h)(5), (i)(1), (2), (3), or (5), ⟦(j)(1) or (2)⟧ *(j)(1), (2), or (5)*, (k)(8), (l)(1), (2), (3), (5), (10), (11), (12), (13), (14), (15), or (17) or (o)(1), or the General Accounting Office, either—

(I) * * *

* * * * * * *

SEC. 6104. PUBLICITY OF INFORMATION REQUIRED FROM CERTAIN EXEMPT ORGANIZATIONS AND CERTAIN TRUSTS.

(a) INSPECTION OF APPLICATIONS FOR TAX EXEMPTION.—

(1) PUBLIC INSPECTION.—

(A) * * *

(B) PENSION, ETC., PLANS.—The following shall be open to public inspection at such times and in such places as the Secretary may prescribe:

(i) any application filed with respect to the qualification of a pension, profit-sharing, or stock bonus plan under section 401(a) or 403(a), an individual retirement account described in section 408(a), *a family development account described in section 1400H(e),* or an individual retirement annuity described in section 408(b),

* * * * * * *

⟦(d) PUBLIC INSPECTION OF PRIVATE FOUNDATIONS' ANNUAL RETURNS.—The annual return required to be filed under section 6033 (relating to returns by exempt organizations) by any organization which is a private foundation within the meaning of section 509(a) shall be made available by the foundation managers for inspection at the principal office of the foundation during regular business hours by any citizen on request made within 180 days after the date of the publication of notice of its availability. Such notice shall be published, not later than the day prescribed for filing such annual return (determined with regard to any extension of time for filing), in a newspaper having general circulation in the county in which the principal office of the private foundation is located. The notice shall state that the annual return of the private foundation is available at its principal office for inspection during regular business hours by any citizen who requests it within 180 days after the date of such publication, and shall state the address and the telephone number of the private foundation's principal office and the name of its principal manager.

⟦(e) PUBLIC INSPECTION OF CERTAIN ANNUAL RETURNS AND APPLICATIONS FOR EXEMPTION.—

⟦(1) ANNUAL RETURNS.—

⟦(A) IN GENERAL.—During the 3-year period beginning on the filing date—

⟦(i) a copy of the annual return filed under section 6033 (relating to returns by exempt organizations) by any organization to which this paragraph applies shall be made available by such organization for inspection during regular business hours by any individual at the principal office of such organization and, if such organization regularly maintains 1 or more regional or district offices having 3 or more employees, at each such regional or district office, and

⟦(ii) upon request of an individual made at such principal office or such a regional or district office, a copy of such annual return shall be provided to such individual without charge other than a reasonable fee for any reproduction and mailing costs.

The request described in clause (ii) must be made in person or in writing. If the request under clause (ii) is made in person, such copy shall be provided immediately and, if made in writing, shall be provided within 30 days.

⟦(B) ORGANIZATIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any organization which—

⟦(i) is described in subsection (c) or (d) of section 501 and exempt from taxation under section 501(a), and [(ii) is not a private foundation (within the meaning of section 509(a)).

[(C) NONDISCLOSURE OF CONTRIBUTORS.—Subparagraph (A) shall not require the disclosure of the name or address of any contributor to the organization. In the case of an organization described in section 501(d), subparagraph (A) shall not require the disclosure of the copies referred to in section 6031(b) with respect to such organization.

[(D) FILING DATE.—For purposes of subparagraph (A), the term "filing date" means the last day prescribed for filing the return under section 6033 (determined with regard to any extension of time for filing).

[(2) APPLICATION FOR EXEMPTION.—

[(A) IN GENERAL.—If—

[(i) an organization described in subsection (c) or (d) of section 501 is exempt from taxation under section 501(a), and

[(ii) such organization filed an application for recognition of exemption under section 501, a copy of such application (together with a copy of any papers submitted in support of such application and any letter or other document issued by the Internal Revenue Service with respect to such application) shall be made available by the organization for inspection during regular business hours by any individual at the principal office of the organization and, if the organization regularly maintains 1 or more regional or district offices having 3 or more employees, at each such regional or district office (and, upon request of an individual made at such principal office or such a regional or district office, a copy of the material requested to be available for inspection under this subparagraph shall be provided (in accordance with the last sentence of paragraph (1)(A)) to such individual without charge other than reasonable fee for any reproduction and mailing costs).

[(B) NONDISCLOSURE OF CERTAIN INFORMATION.—Subparagraph (A) shall not require the disclosure of any information if the Secretary withheld such information from public inspection under subsection (a)(1)(D).

[(3) LIMITATION.—Paragraph (1)(A)(ii) (and the corresponding provision of paragraph (2)) shall not apply to any request if, in accordance with regulations promulgated by the Secretary, the organization has made the requested documents widely available, or, the Secretary determines, upon application by an organization, that such request is part of a harassment campaign and that compliance with such request is not in the public interest.]

(d) PUBLIC INSPECTION OF CERTAIN ANNUAL RETURNS AND APPLICATIONS FOR EXEMPTION.—

(1) IN GENERAL.—In the case of an organization described in subsection (c) or (d) of section 501 and exempt from taxation under section 501(a)—

(A) a copy of—

(i) the annual return filed under section 6033 (relating to returns by exempt organizations) by such organization, and

(ii) if the organization filed an application for recognition of exemption under section 501, the exempt status application materials of such organization,

shall be made available by such organization for inspection during regular business hours by any individual at the principal office of such organization and, if such organization regularly maintains 1 or more regional or district offices having 3 or more employees, at each such regional or district office, and

(B) upon request of an individual made at such principal office or such a regional or district office, a copy of such annual return and exempt status application materials shall be provided to such individual without charge other than a reasonable fee for any reproduction and mailing costs.

The request described in subparagraph (B) must be made in person or in writing. If such request is made in person, such copy shall be provided immediately and, if made in writing, shall be provided within 30 days.

(2) 3-YEAR LIMITATION ON INSPECTION OF RETURNS.—Paragraph (1) shall apply to an annual return filed under section 6033 only during the 3-year period beginning on the last day prescribed for filing such return (determined with regard to any extension of time for filing).

(3) EXCEPTIONS FROM DISCLOSURE REQUIREMENT.—

(A) NONDISCLOSURE OF CONTRIBUTORS, ETC.—Paragraph (1) shall not require the disclosure of the name or address of any contributor to the organization. In the case of an organization described in section 501(d), subparagraph (A) shall not require the disclosure of the copies referred to in section 6031(b) with respect to such organization.

(B) NONDISCLOSURE OF CERTAIN OTHER INFORMATION.—Paragraph (1) shall not require the disclosure of any information if the Secretary withheld such information from public inspection under subsection (a)(1)(D).

(4) LIMITATION ON PROVIDING COPIES.—Paragraph (1)(B) shall not apply to any request if, in accordance with regulations promulgated by the Secretary, the organization has made the requested documents widely available, or the Secretary determines, upon application by an organization, that such request is part of a harassment campaign and that compliance with such request is not in the public interest.

(5) EXEMPT STATUS APPLICATION MATERIALS.—For purposes of paragraph (1), the term "exempt status applicable materials" means the application for recognition of exemption under section 501 and any papers submitted in support of such application and any letter or other document issued by the Internal Revenue Service with respect to such application.

* * * * * * *

CHAPTER 64—COLLECTION

*   *   *   *   *   *   *

Subchapter B—Receipt of Payment

*   *   *   *   *   *   *

SEC. 6311. PAYMENT OF TAX BY COMMERCIALLY ACCEPTABLE MEANS.

(a) * * *

*   *   *   *   *   *   *

(d) PAYMENT BY OTHER MEANS.—

(1) * * *

(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 related 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⟧ *under any such contract for the use of credit or debit cards for the payment of taxes imposed by subtitle A*.

*   *   *   *   *   *   *

CHAPTER 65—ABATEMENTS, CREDITS, AND REFUNDS

*   *   *   *   *   *   *

Subchapter A—Procedure in General

*   *   *   *   *   *   *

SEC. 6404. ABATEMENTS.

(a) * * *

*   *   *   *   *   *   *

(h) ABATEMENT OF INTEREST ON UNDERPAYMENTS BY TAXPAYERS IN PRESIDENTIALLY DECLARED DISASTER AREAS.—

(1) * * *

(2) PRESIDENTIALLY DECLARED DISASTER AREA.—For purposes of paragraph (1), the term "Presidentially declared disaster area" means, with respect to any taxpayer, any area which the President has determined warrants assistance by the Federal Government under the *Robert T. Stafford* Disaster Relief and Emergency Assistance Act.

*   *   *   *   *   *   *

CHAPTER 66—LIMITATIONS

*   *   *   *   *   *   *

Subchapter A—Limitations on Assessment and Collection

* * * * * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) * * *

* * * * * * *

(c) EXCEPTIONS.—

(1) * * *

* * * * * * *

(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.⟧

* * * * * * *

CHAPTER 68—ADDITIONS TO THE TAX, ADDITIONAL AMOUNTS, AND ASSESSABLE PENALTIES

* * * * * * *

Subchapter A—Additions to the Tax and Additional Amounts

* * * * * * *

PART I—GENERAL PROVISIONS

* * * * * * *

SEC. 6652. FAILURE TO FILE CERTAIN INFORMATION RETURNS, REGISTRATION STATEMENTS, ETC.

(a) * * *

* * * * * * *

(c) RETURNS BY EXEMPT ORGANIZATIONS AND BY CERTAIN TRUSTS.—

(1) ANNUAL RETURNS UNDER SECTION 6033.—

(A) * * *

* * * * * * *

(C) PUBLIC INSPECTION OF ANNUAL RETURNS.—In the case of a failure to comply with the requirements of ⟦subsection (d) or (e)(1) of section 6104 (relating to public inspection of annual returns)⟧ *section 6104(d) with respect to* *any annual return* on the date and in the manner prescribed therefor (determined with regard to any extension of time for filing), there shall be paid by the person failing to meet such requirements $20 for each day during which such failure continues. The maximum penalty imposed under this subparagraph on all persons for failures with respect to any 1 return shall not exceed $10,000.

(D) PUBLIC INSPECTION OF APPLICATIONS FOR EXEMPTION.—In the case of a failure to comply with the requirements of ❲section 6104(e)(2) (relating to public inspection of applications for exemption)❳ *section 6104(d) with respect to any exempt status application materials (as defined in such section)* on the date and in the manner prescribed therefor, there shall be paid by the person failing to meet such requirements $20 for each day during which such failure continues.

* * * * * * *

Subchapter B—Assessable Penalties

* * * * * * *

PART I—GENERAL PROVISIONS

* * * * * * *

SEC. 6685. ASSESSABLE PENALTY WITH RESPECT TO PUBLIC INSPECTION REQUIREMENTS FOR CERTAIN TAX-EXEMPT ORGANIZATIONS.

In addition to the penalty imposed by section 7207 (relating to fraudulent returns, statements, or other documents), any person who is required to comply with the requirements of subsection (d) ❲or (e)❳ of section 6104 and who fails to so comply with respect to any return or application, if such failure is willful, shall pay a penalty of $5,000 with respect to each such return or application.

* * * * * * *

SEC. 6693. FAILURE TO PROVIDE REPORTS ON CERTAIN TAX-FAVORED ACCOUNTS OR ANNUITIES; PENALTIES RELATING TO DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.

(a) REPORTS.—

(1) * * *

(2) PROVISIONS.—The provisions referred to in this paragraph are—

(A) * * *

* * * * * * *

(C) ❲Section❳ *section* 529(d) (relating to ❲qualified State tuition programs❳ *qualified tuition programs*), ❲and❳

(D) ❲Section❳ *section* 530(h) (relating to education individual retirement accounts)❲.❳*, and*

(E) section 1400H(g)(7) (relating to family development accounts).

* * * * * * *

CHAPTER 75—CRIMES, OTHER OFFENSES, AND FORFEITURES

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Subchapter A—Crimes

* * * * * * *

PART I—GENERAL PROVISIONS

* * * * * * *

SEC. 7207. FRAUDULENT RETURNS, STATEMENTS, OR OTHER DOCUMENTS.

Any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter, shall be fined not more than $10,000 ($50,000 in the case of a corporation), or imprisoned not more than 1 year, or both. Any person required pursuant to subsection (b) of section 6047 or pursuant to subsection (d) ⟦or (e)⟧ of section 6104 to furnish any information to the Secretary or any other person who willfully furnishes to the Secretary or such other person any information known by him to be fraudulent or to be false as to any material matter shall be fined not more than $10,000 ($50,000 in the case of a corporation), or imprisoned not more than 1 year, or both.

* * * * * * *

CHAPTER 76—JUDICIAL PROCEEDINGS

* * * * * * *

Subchapter B—Proceedings by Taxpayers and Third Parties

* * * * * * *

SEC. 7421. PROHIBITION OF SUITS TO RESTRAIN ASSESSMENT OR COLLECTION.

(a) TAX.—Except as provided in sections ⟦6015(d)⟧ *6015(e)*, 6212(a) and (c), 6213(a), 6225(b), 6246(b), *6331(i),* 6672(b), 6694(c), 7426(a) and (b)(1), and 7429(b), and 7463 no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.

* * * * * * *

Subchapter E—Burden of Proof

* * * * * * *

SEC. 7491. BURDEN OF PROOF.

(a) BURDEN SHIFTS WHERE TAXPAYER PRODUCES CREDIBLE EVIDENCE.—

(1) * * *

(2) LIMITATIONS.—Paragraph (1) shall apply with respect to an issue only if—

(A) the taxpayer has complied with the requirements under this title to substantiate any item;

(B) the taxpayer has maintained all records required under this title and has cooperated with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews; and

(C) in the case of a partnership, corporation, or trust, the taxpayer is described in section 7430(c)(4)(A)(ii).

Subparagraph (C) shall not apply to any qualified revocable trust (as defined in section 645(b)(1)) with respect to liability for tax for any taxable year ending after the date of the decedent's death and before the applicable date (as defined in section 645(b)(2)).

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Subtitle I—Trust Fund Code

* * * * * * *

CHAPTER 98—TRUST FUND CODE

* * * * * * *

Subchapter A—Establishment of Trust Fund

* * * * * * *

SEC. 9503. HIGHWAY TRUST FUND.

(a) * * *

* * * * * * *

(f) DETERMINATION OF TRUST FUND BALANCES AFTER SEPTEMBER 30, 1998.—For purposes of determining the balances of the Highway Trust Fund and the Mass Transit Account after September 30, 1998—

(1) the opening balance of the Highway Trust Fund (other than the Mass Transit Account) on October 1, 1998, shall be $8,000,000,000, and

[(2) no interest accruing after September 30, 1998, on any obligation held by such Fund shall be credited to such Fund.]

(2) notwithstanding section 9602(b), obligations held by such Fund after September 30, 1998, shall be obligations of the United States which are not interest-bearing.

The Secretary shall cancel obligations held by the Highway Trust Fund to reflect the reduction in the balance under this subsection.

* * * * * * *

SEC. 9510. VACCINE INJURY COMPENSATION TRUST FUND.

(a) * * *

(b) TRANSFERS TO TRUST FUND.—

(1) * * *

* * * * * * *

(3) LIMITATION ON TRANSFERS TO VACCINE INJURY COMPENSATION TRUST FUND.—No amount may be appropriated to the Vaccine Injury Compensation Trust Fund on and after the date of any expenditure from the Trust Fund which is not permitted by this section. The determination of whether an expenditure is so permitted shall be made without regard to—

(A) any provision of law which is not contained or referenced in this title or in a revenue Act, and

(B) whether such provision of law is a subsequently enacted provision or directly or indirectly seeks to waive the application of this paragraph.

(c) EXPENDITURES FROM TRUST FUND.—

[(1) IN GENERAL.—Amounts in the Vaccine Injury Compensation Trust Fund shall be available, as provided in appropriation Acts, only for the payment of compensation under subtitle 2 of title XXI of the Public Health Service Act (as in effect on the date of the enactment of this section) for vaccine-related injury or death with respect to vaccines administered after September 30, 1988 or for the payment of all expenses of administration (but not in excess of $6,000,000 for any fiscal year) incurred by the Federal Government in administering such subtitle.]

(1) IN GENERAL.—Amounts in the Vaccine Injury Compensation Trust Fund shall be available, as provided in appropriation Acts, only for—

(A) the payment of compensation under subtitle 2 of title XXI of the Public Health Service Act (as in effect on August 5, 1997) for vaccine-related injury or death with respect to any vaccine—

(i) which is administered after September 30, 1988, and

(ii) which is a taxable vaccine (as defined in section 4132(a)(1)) at the time compensation is paid under such subtitle 2, or

(B) the payment of all expenses of administration (but not in excess of $9,500,000 for any fiscal year) incurred by the Federal Government in administering such subtitle.

* * * * * * *

SOCIAL SECURITY ACT

* * * * * * *

TITLE II—FEDERAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE BENEFITS

* * * * * * *

REDUCTION OF INSURANCE BENEFITS

Maximum Benefits

SEC. 203. (a) * * *

* * * * * * *

Months to Which Earnings Are Charged

(f) For purposes of subsection (b)—

(1) * * *

* * * * * * *

(8)(A) * * *

(B) Except as otherwise provided in subparagraph (D), the exempt amount which is applicable to individuals described in such subparagraph and the exempt amount which is applicable to other individuals, for each month of a particular taxable year, shall each be whichever of the following is the larger—

(i) * * *

(ii) the product of the corresponding exempt amount which is in effect with respect to months in the taxable year ending [after 2001 and before 2003] *after 2007 and before 2009* (with respect to individuals described in subparagraph (D)) or the taxable year ending after 1993–and before 1995 (with respect to other individuals), and the ratio of—

(I) the national average wage index (as defined in section 209(k)(1)) for the calendar year before the calendar year in which the determination under subparagraph (A) is made, to

(II) the national average wage index (as so defined) for [2000] *2006* (with respect to individuals described in subparagraph (D)) or 1992 (with respect to other individuals),

with such product, if not a multiple of $10, being rounded to the next higher multiple of $10 where such product is a multiple of $5 but not of $10 and to the nearest multiple of $10 in any other case.

* * * * * * *

(D) Notwithstanding any other provision of this subsection, the exempt amount which is applicable to an individual who has attained retirement age (as defined in section 216(l)) before the close of the taxable year involved shall be—

(i) * * *

* * * * * * *

[(iv) for each month of any taxable year ending after 1998 and before 2000, $1,291.66⅔,

[(v) for each month of any taxable year ending after 1999 and before 2001, $1,416.66⅔,

[(vi) for each month of any taxable year ending after 2000 and before 2002, $2,083.33⅓,

[(vii) for each month of any taxable year ending after 2001 and before 2003, $2,500.00.]

(iv) for each month of any taxable year ending after 1998 and before 2000, $1,416.66⅔,

(v) for each month of any taxable year ending after 1999 and before 2001, $1,541.66⅔,

(vi) for each month of any taxable year ending after 2000 and before 2002, $2,166.66⅔,

(vii) for each month of any taxable year ending after 2001 and before 2003, $2,500.00,

(viii) for each month of any taxable year ending after 2002 and before 2004, $2,608.33⅓,

(ix) for each month of any taxable year ending after 2003 and before 2005, $2,833.33⅓,

(x) for each month of any taxable year ending after 2004 and before 2006, $2,950.00,

(xi) for each month of any taxable year ending after 2005 and before 2007, $3,066.66⅔,

(xii) for each month of any taxable year ending after 2006 and before 2008, $3,195.83⅓, and

(xiii) for each month of any taxable year ending after 2007 and before 2009, $3,312.50.

* * * * * * *

COMPUTATION OF PRIMARY INSURANCE AMOUNT

SEC. 215. For the purposes of this title—

Primary Insurance Amount

(a) * * *

* * * * * * *

Recomputation of Benefits

(f)(1) * * *

(2) If an individual has wages or self-employment income for a year after 1965 for any part of which he is entitled to old-age insurance benefits, the Secretary shall, at such time or times and within such period as he may by regulations prescribe, recompute such individual's primary insurance amount with respect to each such year. Such recomputation shall be made as provided in subsections (a)(1) (A) and (C) and (a)(3) as though the year with respect to which such recomputation is made is the last year of the period specified in subsection (b)(2)(C). A recomputation under this paragraph with respect to any year shall be effective—

(A)[1] [in the case of an individual who did not die in such year, for monthly benefits beginning with benefits for January of the following year; or] *in the case of an individual who did not die in the year with respect to which the recomputation is made, for monthly benefits beginning with benefits for January of—*

(i) the second year following the year with respect to which the recomputation is made, in any such case in

[1] Subparagraph (A) as in effect in December 1978 and applied in certain cases under the provisions of such Act as in effect after December 1978.

which the individual is entitled to old-age insurance benefits, the individual has attained age 65 as of the end of the year preceding the year with respect to which the recomputation is made, and the year with respect to which the recomputation is made would not be substituted in recomputation under this subsection for a benefit computation year in which no wages or self-employment income have been credited previously to such individual, or

(ii) the first year following the year with respect to which the recomputation is made, in any other such case; or

* * * * * * *

(D) A recomputation under this paragraph with respect to any year shall be effective—

⟦(i) in the case of an individual who did not die in that year, for monthly benefits beginning with benefits for January of the following year; or⟧

(i) in the case of an individual who did not die in the year with respect to which the recomputation is made, for monthly benefits beginning with benefits for January of—

(I) the second year following the year with respect to which the recomputation is made, in any such case in which the individual is entitled to old-age insurance benefits, the individual has attained retirement age (as defined in section 216(l)) as of the end of the year preceding the year with respect to which the recomputation is made, and the year with respect to which the recomputation is made would not be substituted in recomputation under this subsection for a benefit computation year in which no wages or self-employment income have been credited previously to such individual, or

(II) the first year following the year with respect to which the recomputation is made, in any other such case; or

* * * * * * *

(7) This subsection as in effect in December 1978*, and as amended by section 122(b)(2) of the Taxpayer Relief Act of 1998,* shall continue to apply to the recomputation of a primary insurance amount computed under subsection (a) or (d) as in effect (without regard to the table in subsection (a)) in that month, and, where appropriate, under subsection (d) as in effect in December 1977, including a primary insurance amount computed under any such subsection whose operation is modified as a result of the amendments made by section 5117 of the Omnibus Budget Reconciliation Act of 1990. For purposes of recomputing a primary insurance amount determined under subsection (a) or (d) (as so in effect) in the case of an individual to whom those subsections apply by reason of subsection (a)(4)(B) as in effect after December 1978, no remuneration shall be taken into account for the year in which the individual initially became eligible for an old-age or disability insurance benefit or died, or for any year thereafter, and (effective January 1982) the recomputation shall be modified by the application of subsection (a)(6) where applicable.

* * * * * * *

DISABILITY INSURANCE BENEFIT PAYMENTS

Disability Insurance Benefits

SEC. 223. (a) * * *

* * * * * * *

Definition of Disability

(d)(1) * * *

* * * * * * *

(4)(A) The Commissioner of Social Security shall by regulations prescribe the criteria for determining when services performed or earnings derived from services demonstrate an individual's ability to engage in substantial gainful activity. No individual who is blind shall be regarded as having demonstrated an ability to engage in substantial gainful activity on the basis of earnings that do not exceed an amount equal to the exempt amount which would be applicable under section 203(f)(8), to individuals described in subparagraph (D) thereof, if section 102 of the Senior Citizens' Right to Work Act of 1996 *and section 121 of the Taxpayer Relief Act of 1998* had not been enacted. Notwithstanding the provisions of paragraph (2), an individual whose services or earnings meet such criteria shall, except for purposes of section 222(c), be found not to be disabled. In determining whether an individual is able to engage in substantial gainful activity by reason of his earnings, where his disability is sufficiently severe to result in a functional limitation requiring assistance in order for him to work, there shall be excluded from such earnings an amount equal to the cost (to such individual) of any attendant care services, medical devices, equipment, prostheses, and similar items and services (not including routine drugs or routine medical services unless such drugs or services are necessary for the control of the disabling condition) which are necessary (as determined by the Commissioner of Social Security in regulations) for that purpose, whether or not such assistance is also needed to enable him to carry out his normal daily functions; except that the amount to be excluded shall be subject to such reasonable limits as the Commissioner of Social Security may prescribe.

* * * * * * *

TAXPAYER RELIEF ACT OF 1997

* * * * * * *

TITLE IX—MISCELLANEOUS PROVISIONS

* * * * * * *

Subtitle B—Revisions Relating to Disasters

* * * * * * *

SEC. 915. ABATEMENT OF INTEREST ON UNDERPAYMENTS BY TAXPAYERS IN PRESIDENTIALLY DECLARED DISASTER AREAS.

(a) * * *

(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 *or 1998* 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.⟧

(d) EFFECTIVE DATE.—This section shall apply to taxable years ending with or within calendar year 1997.

* * * * * * *

Subtitle D—Provisions Relating to Small Businesses

* * * * * * *

SEC. 933. AVERAGING OF FARM INCOME OVER 3 YEARS.

(a) * * *

* * * * * * *

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1997⟦, and before January 1, 2001⟧.

* * * * * * *

SECTION 505 OF THE TRADE ACT OF 1974

SEC. 505. DATE OF TERMINATION.

No duty-free treatment provided under this title shall remain in effect after ⟦June 30, 1998⟧ *February 29, 2000.*

INTERNAL REVENUE SERVICE RESTRUCTURING AND REFORM ACT OF 1998

* * * * * * *

TITLE III—TAXPAYER PROTECTION AND RIGHTS

* * * * * * *

Subtitle D—Provisions Relating to Interest and Penalties

SEC. 3301. ELIMINATION OF INTEREST RATE DIFFERENTIAL ON OVERLAPPING PERIODS OF INTEREST ON TAX OVERPAYMENTS AND UNDERPAYMENTS.

(a) * * *

* * * * * * *

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided under paragraph (2), the amendments made by this section shall apply to interest for periods beginning after the date of the enactment of this Act.

(2) SPECIAL RULE.—❲The amendments❳ *Subject to any applicable statute of limitation not having expired with regard to either a tax underpayment or a tax overpayment, the amendments* made by this section shall apply to interest for periods beginning before the date of the enactment of this Act if the taxpayer—

(A) reasonably identifies and establishes periods of such tax overpayments and underpayments for which the zero rate applies; and

(B) not later than December 31, 1999, requests the Secretary of the Treasury to apply section 6621(d) of the Internal Revenue Code of 1986, as added by subsection (a), to such periods.

* * * * * * *

Subtitle E—Protections for Taxpayers Subject to Audit or Collection Activities

PART I—DUE PROCESS

SEC. 3401. DUE PROCESS IN INTERNAL REVENUE SERVICE COLLECTION ACTIONS.

(a) * * *

* * * * * * *

(c) REVIEW BY SPECIAL TRIAL JUDGES ALLOWED.—

(1) IN GENERAL.—Section ❲7443(b)❳ *7443A(b)* (relating to proceedings which may be assigned to special trial judges) is amended by striking “and” at the end of paragraph (3), by redesignating paragraph (4) as paragraph (5), and by inserting after paragraph (3) the following new paragraph:

“(4) any proceeding under section 6320 or 6330, and”.

(2) AUTHORITY TO MAKE DECISIONS.—Section [7443(c)] *7443A(c)* (relating to authority to make court decisions) is amended by striking “or (3)” and inserting “(3), or (4)”.

*   *   *   *   *   *   *

VII. DISSENTING VIEWS ON H.R. 4579 THE TAXPAYER RELIEF ACT OF 1998

Democratic Members of this Committee have voted for every major deficit reduction act signed by a Democratic or Republican President—unlike any of the Republicans sitting on this panel. The fiscal discipline embodied in these acts has helped to spark economic growth and lower interest rates with substantial benefits to all working Americans.

This commitment to fiscal discipline has moved us from an economy riddled with annual deficits of up to $300 billion to projected unified budget surpluses. We are now at a point where we can tackle the most difficult of all long-term budget problems, securing Social Security for the long term.

We should not abandon fiscal discipline or pass up this opportunity to preserve Security Social simply because it is seven weeks before an election. We agree with Federal Reserve Board Chairman Alan Greenspan who has urged caution:

> My first choice is to retire debt as much as we can, because it has a positive economic impact * * * The overall effect of a large surplus is to increase national savings, reduce long-term interest rates, and create positive add-ons to the economy * * * There is no need to rush into any particular action, because the debt will be reduced automatically.

Republicans will say that our vigilance in protecting Social Security is just an excuse to oppose these tax cuts. We Democrats do not oppose tax cuts. We support tax cuts. Every single one of us voted for significant tax cuts last year. We Democrats supported a substitute that provided even more tax relief for the middle-class than ultimately was enacted. That bill was fiscally responsible—it was paid for.

Many of the provisions in this tax bill originally were sponsored by Democrats. Marriage penalty relief; 100 percent deductibility of the self-employed health insurance premiums; and simplifying minimum tax rules to ensure that those promised the $500-per-child credit will be fully eligible for it—these have all been introduced in this Congress by Committee on Ways and Means' Democrats. People can check the record and see that it is the Republicans on this Committee who voted them down last year or refused to take them up.

So, make no mistake. We support fiscally responsible tax cuts, but we do not support using the Social Security surplus in order to pay for them. Therefore, we will support the Committee bill under the condition that the tax cuts go into effect as soon as we have achieved the President's goal of saving Social Security first. We offered an amendment to do just that. If that amendment had been adopted, the Committee bill would have a chance of actually becoming law. Republicans defeated it and, therefore, ensured that tax provisions that we all support will not become law this year—since the President will veto this irresponsible bill.

The Republicans argue that the projected surpluses are sufficient to both cut taxes and preserve Social Security. They also argue that they are reserving 90 percent of the surpluses for Social Security. These assertions simply are not true.

The Republicans admit that 10 percent of the surplus is being diverted from Social Security under this bill. Moreover, there is nothing in the Republican proposal that actually reserves the other 90 percent for Social Security. In separate legislation, Republicans say they will "protect" Social Security. However, in that bill they merely require the Secretary of the Treasury to make several bookkeeping entries. They do not prevent the Congress from using the Social Security surplus for further tax cuts or further increases in spending. Under their plan, Congress could use the entire amount of the Social Security surplus next year for tax cuts or spending increases. There is nothing in the Republican proposal that would prevent Congress from doing so. With this bill they already have their noses under the Social Security tent.

When we talk about future budget surpluses, we should be clear that we are speaking about projections. Hopefully, the projections will be accurate, but there are many unforseen events in our global economy. It would be foolhardly to assume that we can predict all of them. That is why no less an authority than Alan Greenspan has warned this Congress that we should not spend money we may not have.

Even if we assume the optimistic projections will come true, the so-called surplus over the next 5 years is not really a surplus. It is due to the contributions that American workers have made to Social Security. It already has been committed to the Social Security trust fund. If we treated those contributions like all businesses treat their contributions to their employees' retirement plans, we would have a $137 billion deficit over the next 5 years and only a $31 billion surplus over the next 10 years, even if the optimistic assumptions prove to be correct.

Perhaps spending some of this money would not be so bad if it really was not needed to shore up Social Security. We all know the challenge that Social Security faces as the baby-boomers near retirement. The reality is that all of the money that Congress has committed to the Social Security program is needed, not only 90 percent of the surplus.

We compliment Chairman Archer for the substance of the tax bill. The substitute we offered would have allowed the Chairman's bill to take effect after we ensure the solvency of the Social Security system. We all have committed to taking action early next year on the Social Security problem. Acting now would violate our commitment to the Social Security trust fund.

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