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REPORT
106–289

TAXPAYER REFUND AND RELIEF ACT OF 1999

CONFERENCE REPORT

TO ACCOMPANY

H.R. 2488

AUGUST 4, 1999.—Ordered to be printed

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106TH CONGRESS, 1st Session | HOUSE OF REPRESENTATIVES | REPORT 106–289

TAXPAYER REFUND AND RELIEF ACT OF 1999

AUGUST 4, 1999.—Ordered to be printed

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

CONFERENCE REPORT

[To accompany H.R. 2488]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2488), to provide for reconciliation pursuant to sections 105 and 211 of the concurrent resolution on the budget for fiscal year 2000, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

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

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

SECTION 1. SHORT TITLE; ETC.

(a) SHORT TITLE.—This Act may be cited as the "Taxpayer Refund and Relief Act of 1999".

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

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

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

Sec. 1. Short title; etc.

TITLE I—BROAD-BASED AND FAMILY TAX RELIEF

Subtitle A—Reduction in Individual Income Taxes

Sec. 101. Reduction in individual income taxes.

Subtitle B—Family Tax Relief

Sec. 111. Elimination of marriage penalty in standard deduction.
Sec. 112. Exclusion for foster care payments to apply to payments by qualified placement agencies.
Sec. 113. Expansion of adoption credit.
Sec. 114. Modification of dependent care credit.
Sec. 115. Marriage penalty relief for earned income credit.

Subtitle C—Repeal of Alternative Minimum Tax on Individuals

Sec. 121. Repeal of alternative minimum tax on individuals.

TITLE II—RELIEF FROM TAXATION ON SAVINGS AND INVESTMENTS

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Sec. 201. Reduction in individual capital gain tax rates.
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SEC. 101. REDUCTION IN INDIVIDUAL INCOME TAXES.

(a) REGULAR INCOME TAX RATES.—

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

"(8) RATE REDUCTIONS.—The following adjustments shall apply in prescribing the tables under paragraph (1):

"(A) REDUCTION IN LOWEST RATE.—With respect to taxable years beginning after December 31, 2000, the rate applicable to the lowest income bracket shall be—

"(i) 14.5 percent in the case of taxable years beginning during 2001 or 2002, and

"(ii) 14.0 percent in the case of taxable years beginning after 2002.

"(B) REDUCTION IN OTHER RATES.—With respect to taxable years beginning after December 31, 2004, each rate

(other than the rate referred to in subparagraph (A)) shall be reduced by 1 percentage point.

"(C) PHASEOUT OF MARRIAGE PENALTY IN LOWEST BRACKET.—

"(i) IN GENERAL.—With respect to taxable years beginning after December 31, 2004—

"(I) the maximum taxable income in the lowest rate bracket in the table contained in subsection (a) (and the minimum taxable income in the next higher taxable income bracket in such table) shall be the applicable percentage of the maximum taxable income in the lowest rate bracket in the table contained in subsection (c) (after any other adjustment under this subsection), and

"(II) the comparable taxable income amounts in the table contained in subsection (d) shall be ½ of the amounts determined under subclause (I).

"(ii) APPLICABLE PERCENTAGE.—For purposes of clause (i), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2005	*173.7*
2006	*176.1*
2007	*188.1*
2008 and thereafter	*200.0.*

"(D) INCREASE IN MAXIMUM TAXABLE INCOME IN LOWEST BRACKET FOR OTHER INDIVIDUALS.—

"(i) IN GENERAL.—With respect to taxable years beginning after December 31, 2005, the maximum taxable income in the lowest rate bracket in the tables contained in subsections (b) and (c), after any other adjustment under this subsection (and the minimum taxable income in the next higher taxable income bracket in such tables, as so adjusted) shall be increased by $3,000.

"(ii) COST-OF-LIVING ADJUSTMENT.—In the case of any taxable year beginning in any calendar year after 2006, the $3,000 amount in clause (i) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of living adjustment determined under paragraph (3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2005' for 'calendar year 1992' in subparagraph (B) thereof.".

"(iii) Any increase under clause (ii) shall be added to the amount it is increasing before such amount is rounded under paragraph (6).

"(9) POST-2001 RATE REDUCTIONS CONTINGENT ON NO INCREASE IN INTEREST ON TOTAL UNITED STATES DEBT.—

"(A) IN GENERAL.—If the calendar year preceding any adjustment year is not a debt reduction calendar year, then—

"(i) such adjustment shall not take effect until the calendar year following the adjustment year, and

"(ii) this subparagraph shall apply to such following calendar year as if it were an adjustment year. For purposes of this subparagraph, the term 'adjustment year' means, with respect to any adjustment under subparagraph (A), (B), or (D) of paragraph (8), the first calendar year for which such adjustment takes effect without regard to this paragraph.

"(B) DEBT REDUCTION CALENDAR YEAR.—For purposes of this paragraph, the term 'debt reduction calendar year' means any calendar year after 2000 if the Secretary of the Treasury (after consultation with the chairman of the Federal Reserve Board) determines by August 31 of such calendar year that the United States interest expense for the 12-month period ending on July 31 of such calendar year is not more than $1,000,000,000 greater than the United States interest expense for the 12-month period ending on July 31 of the preceding calendar year.

"(C) UNITED STATES INTEREST EXPENSE.—For purposes of this paragraph, the term 'United States interest expense' means interest on obligations which are subject to the public debt limit in section 3101 of title 31, United States Code.".

(2) TECHNICAL AMENDMENTS.—

(A) Subparagraph (B) of section 1(f)(2) is amended by inserting "except as provided in paragraph (8)," before "by not changing".

(B) Subparagraph (C) of section 1(f)(2) is amended by inserting "and the reductions under paragraph (8) in the rates of tax" before the period.

(C) The heading for subsection (f) of section 1 is amended by inserting "RATE REDUCTIONS;" before "ADJUSTMENTS".

(D) Section 1(g)(7)(B)(ii)(II) is amended by striking "15 percent" and inserting "the percentage applicable to the lowest income bracket in subsection (c)".

(E) Subparagraphs (A)(ii)(I) and (B)(i) of section 1(h)(1) are each amended by striking "28 percent" and inserting "27 percent".

(F) Section 531 is amended by striking "39.6 percent of the accumulated taxable income" and inserting "the product of the accumulated taxable income and the percentage applicable to the highest income bracket in section 1(c)".

(G) Section 541 is amended by striking "39.6 percent of the undistributed personal holding company income" and inserting "the product of the undistributed personal holding company income and the percentage applicable to the highest income bracket in section 1(c)".

(H) Section 3402(p)(1)(B) is amended by striking "specified is 7, 15, 28, or 31 percent" and all that follows and inserting "specified is—

"(i) 7 percent,

"(ii) a percentage applicable to 1 of the 3 lowest income brackets in section 1(c), or

"(iii) such other percentage as is permitted under regulations prescribed by the Secretary.".

(I) Section 3402(p)(2) is amended by striking "15 percent of such payment" and inserting "the product of such payment and the percentage applicable to the lowest income bracket in section 1(c)".

(J) Section 3402(q)(1) is amended by striking "28 percent of such payment" and inserting "the product of such payment and the percentage applicable to the next to the lowest income bracket in section 1(c)".

(K) Section 3402(r)(3) is amended by striking "31 percent" and inserting "the rate applicable to the third income bracket in such section".

(L) Section 3406(a)(1) is amended by striking "31 percent of such payment" and inserting "the product of such payment and the percentage applicable to the third income bracket in section 1(c)".

(b) MINIMUM TAX RATES.—Subparagraph (A) of section 55(b)(1) is amended by adding at the end the following new clause:

"(iv) RATE REDUCTION.—In the case of taxable years beginning after December 31, 2004, each rate in clause (i) shall be reduced by 1 percentage point."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

Subtitle B—Family Tax Relief

SEC. 111. 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 "200 percent of 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) PHASE-IN.—Subsection (c) of section 63 is amended by adding at the end the following new paragraph:

"(7) PHASE-IN OF INCREASE IN BASIC STANDARD DEDUCTION.—In the case of taxable years beginning before January 1, 2005—

"(A) paragraph (2)(A) shall be applied by substituting for '200 percent'—

"(i) '172.8 percent' in the case of taxable years beginning during 2001,

"(ii) '180.1 percent' in the case of taxable years beginning during 2002,

"(iii) '187.0 percent' in the case of taxable years beginning during 2003, and

"(iv) '193.5 percent' in the case of taxable years beginning during 2004, and

"(B) the basic standard deduction for a married individual filing a separate return shall be one-half of the amount applicable under paragraph (2)(A).

If any amount determined under subparagraph (A) is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.".

(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, 2000.

SEC. 112. EXCLUSION FOR FOSTER CARE PAYMENTS TO APPLY TO PAYMENTS BY QUALIFIED PLACEMENT AGENCIES.

(a) IN GENERAL.—The matter preceding subparagraph (B) of section 131(b)(1) (defining qualified foster care payment) is amended to read as follows:

"(1) IN GENERAL.—The term 'qualified foster care payment' means any payment made pursuant to a foster care program of a State or political subdivision thereof—

"(A) which is paid by—

"(i) the State or political subdivision thereof, or

"(ii) a qualified foster care placement agency, and".

(b) QUALIFIED FOSTER INDIVIDUALS TO INCLUDE INDIVIDUALS PLACED BY QUALIFIED PLACEMENT AGENCIES.—Subparagraph (B) of section 131(b)(2) (defining qualified foster individual) is amended to read as follows:

"(B) a qualified foster care placement agency.".

(c) QUALIFIED FOSTER CARE PLACEMENT AGENCY DEFINED.—Subsection (b) of section 131 is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) QUALIFIED FOSTER CARE PLACEMENT AGENCY.—The term 'qualified foster care placement agency' means any placement agency which is licensed or certified by—

"(A) a State or political subdivision thereof, or

"(B) an entity designated by a State or political subdivision thereof,

for the foster care program of such State or political subdivision to make foster care payments to providers of foster care.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 113. EXPANSION OF ADOPTION CREDIT.

(a) IN GENERAL.—Section 23(a)(1) (relating to allowance of credit) is amended to read as follows:

"(1) IN GENERAL.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter—

"(A) in the case of an adoption of a child other than a child with special needs, the amount of the qualified adoption expenses paid or incurred by the taxpayer, and

"(B) in the case of an adoption of a child with special needs, $10,000.".

(b) DOLLAR LIMITATION.—Section 23(b)(1) is amended—

(1) by striking "($6,000, in the case of a child with special needs)", and

(2) by striking "subsection (a)" and inserting "subsection (a)(1)".

(c) YEAR CREDIT ALLOWED.—Section 23(a)(2) is amended by adding at the end the following new flush sentence:

"In the case of the adoption of a child with special needs, the credit allowed under paragraph (1) shall be allowed for the taxable year in which the adoption becomes final.".

(d) DEFINITION OF ELIGIBLE CHILD.—

(1) IN GENERAL.—Section 23(d)(2) is amended to read as follows:

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

"(A) has not attained age 18, or

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

(2) CLARIFICATION OF TERMINATION.—Section 23 is amended by adding at the end the following new subsection:

"(i) TERMINATION FOR CHILDREN WITHOUT SPECIAL NEEDS.—Except in the case of a child with special needs, this section shall not apply to expenses paid or incurred after December 31, 2001."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 114. MODIFICATION OF DEPENDENT CARE CREDIT.

(a) INCREASE IN PERCENTAGE OF EMPLOYMENT-RELATED EXPENSES TAKEN INTO ACCOUNT.—Subsection (a)(2) of section 21 (relating to expenses for household and dependent care services necessary for gainful employment) is amended—

(1) by striking "30 percent" and inserting "35 percent (40 percent in the case of taxable years beginning after December 31, 2005)",

(2) by striking "$2,000" and inserting "$1,000", and

(3) by striking "$10,000" and inserting "$30,000".

(b) INDEXING OF LIMIT ON EMPLOYMENT-RELATED EXPENSES.—Section 21(c) (relating to dollar limit on amount creditable) is amended to read as follows:

"(c) DOLLAR LIMIT ON AMOUNT CREDITABLE.—

"(1) IN GENERAL.—The amount of the employment-related expenses incurred during any taxable year which may be taken into account under subsection (a) shall not exceed—

"(A) an amount equal to 50 percent of the amount determined under subparagraph (B) if there is 1 qualifying individual with respect to the taxpayer for such taxable year, or

"(B) $4,800 if there are 2 or more qualifying individuals with respect to the taxpayer for such taxable year.

The amount determined under subparagraph (A) or (B) (whichever is applicable) shall be reduced by the aggregate amount excludable from gross income under section 129 for the taxable year.

"(2) COST-OF-LIVING ADJUSTMENT.—

"(A) IN GENERAL.—In the case of a taxable year beginning after 2001, the $4,800 amount under paragraph (1)(B) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2000' for 'calendar year 1992' in subparagraph (B) thereof.

"(B) ROUNDING RULES.—If any amount after adjustment under subparagraph (A) is not a multiple of $50, such amount shall be rounded to the next lower multiple of $50.".

(c) MINIMUM DEPENDENT CARE CREDIT ALLOWED FOR STAY-AT-HOME PARENTS.—Section 21(e) (relating to special rules) is amended by adding at the end the following:

"(11) MINIMUM CREDIT ALLOWED FOR STAY-AT-HOME PARENTS.—

"(A) IN GENERAL.—Notwithstanding subsection (d), in the case of any taxpayer with 1 or more qualifying individuals described in subsection (b)(1)(A) under the age of 1, such taxpayer shall be deemed to have employment-related expenses for the taxable year with respect to each such qualifying individual in an amount equal to the sum of—

"(i) $200 for each month in such taxable year during which such qualifying individual is under the age of 1, and

"(ii) the amount of employment-related expenses otherwise incurred for such qualifying individual for the taxable year (determined under this section without regard to this paragraph).

"(B) ELECTION TO NOT APPLY THIS PARAGRAPH.—This paragraph shall not apply with respect to any qualifying individual for any taxable year if the taxpayer elects to not have this paragraph apply to such qualifying individual for such taxable year.".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to taxable years beginning after December 31, 2005.

SEC. 115. MARRIAGE PENALTY RELIEF FOR EARNED INCOME CREDIT.

(a) IN GENERAL.—Paragraph (2) of section 32(b) (relating to percentages and amounts) is amended—

(1) by striking "AMOUNTS.—The earned" and inserting "AMOUNTS.—

"(A) IN GENERAL.—Subject to subparagraph (B), the earned", and

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

"(B) JOINT RETURNS.—In the case of a joint return, the phaseout amount determined under subparagraph (A) shall be increased by $2,000.".

(b) INFLATION ADJUSTMENT.—Paragraph (1)(B) of section 32(j) (relating to inflation adjustments) is amended to read as follows:

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined—

"(i) in the case of amounts in subsections (b)(1)(A) and (i)(1), by substituting 'calendar year 1995' for 'calendar year 1992' in subparagraph (B) thereof, and

"(ii) in the case of the $2,000 amount in subsection (b)(1)(B), by substituting 'calendar year 2005' for 'calendar year 1992' in subparagraph (B) of such section 1.".

(c) ROUNDING.—Section 32(j)(2)(A) (relating to rounding) is amended by striking "subsection (b)(2)" and inserting "subsection (b)(2)(A) (after being increased under subparagraph (B) thereof)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2005.

Subtitle C—Repeal of Alternative Minimum Tax on Individuals

SEC. 121. REPEAL OF ALTERNATIVE MINIMUM TAX ON INDIVIDUALS.

(a) IN GENERAL.—Subsection (a) of section 55 is amended by adding at the end the following new flush sentence:

"For purposes of this title, the tentative minimum tax on any taxpayer other than a corporation for any taxable year beginning after December 31, 2007, shall be zero.".

(b) REDUCTION OF TAX ON INDIVIDUALS PRIOR TO REPEAL.—Section 55 is amended by adding at the end the following new subsection:

"(f) PHASEOUT OF TAX ON INDIVIDUALS.—

"(1) IN GENERAL.—The tax imposed by this section on a taxpayer other than a corporation for any taxable year beginning after December 31, 2004, and before January 1, 2008, shall be the applicable percentage of the tax which would be imposed but for this subsection.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2005	*80*
2006	*70*
2007	*60.".*

(c) NONREFUNDABLE PERSONAL CREDITS FULLY ALLOWED AGAINST REGULAR TAX LIABILITY.—

(1) IN GENERAL.—Subsection (a) of section 26 (relating to limitation based on amount of tax) 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 taxpayer's regular tax liability for the taxable year.".

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

(d) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—Subsection (c) of section 53 is amended to read as follows:

"(c) LIMITATION.—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the credit allowable under subsection (a) for any taxable year shall not exceed the excess (if any) of—

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

"(B) the tentative minimum tax for the taxable year.

"(2) TAXABLE YEARS BEGINNING AFTER 2007.—In the case of any taxable year beginning after 2007, the credit allowable under subsection (a) to a taxpayer other than a corporation for any taxable year shall not exceed 90 percent of the excess (if any) of—

"(A) regular tax liability of the taxpayer for such taxable year, over

"(B) the sum of the credits allowable under subparts A, B, D, E, and F of this part.".

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

TITLE II—RELIEF FROM TAXATION ON SAVINGS AND INVESTMENTS

Subtitle A—Capital Gains Tax Relief

SEC. 201. REDUCTION IN INDIVIDUAL CAPITAL GAIN TAX RATES.

(a) IN GENERAL.—

(1) Sections 1(h)(1)(B) and 55(b)(3)(B) are each amended by striking "10 percent" and inserting "8 percent".

(2) The following sections are each amended by striking "20 percent" and inserting "18 percent":

(A) Section 1(h)(1)(C).

(B) Section 55(b)(3)(C).

(C) Section 1445(e)(1).

(D) The second sentence of section 7518(g)(6)(A).

(E) The second sentence of section 607(h)(6)(A) of the Merchant Marine Act, 1936.

(3) Sections 1(h)(1)(D) and 55(b)(3)(D) are each amended by striking "25 percent" and inserting "23 percent".

(b) CONFORMING AMENDMENTS.—

(1) Section 311 of the Taxpayer Relief Act of 1997 is amended by striking subsection (e).

(2) Section 1(h) is amended—

(A) by striking paragraphs (2), (9), and (13),

(B) by redesignating paragraphs (3) through (8) as paragraphs (2) through (7), respectively, and

(C) by redesignating paragraphs (10), (11), and (12) as paragraphs (8), (9), and (10), respectively.

(3) Paragraph (3) of section 55(b) is amended by striking "In the case of taxable years beginning after December 31, 2000, rules similar to the rules of section 1(h)(2) shall apply for purposes of subparagraphs (B) and (C).".

(4) Paragraph (7) of section 57(a) is amended—

(A) by striking "42 percent" and inserting "28 percent", and

(B) by striking the last sentence.

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided by this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1998.

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

SEC. 202. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER DECEMBER 31, 1999, FOR PURPOSES OF DETERMINING GAIN.

(a) IN GENERAL.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1021 the following new section:

"SEC. 1022. INDEXING OF CERTAIN ASSETS ACQUIRED AFTER DECEMBER 31, 1999, FOR PURPOSES OF DETERMINING GAIN.

"(a) GENERAL RULE.—

"(1) INDEXED BASIS SUBSTITUTED FOR ADJUSTED BASIS.—Solely for purposes of determining gain on the sale or other disposition by a taxpayer (other than a corporation) of an indexed asset which has been held for more than 1 year, the indexed basis of the asset shall be substituted for its adjusted basis.

"(2) EXCEPTION FOR DEPRECIATION, ETC.—The deductions for depreciation, depletion, and amortization shall be determined without regard to the application of paragraph (1) to the taxpayer or any other person.

"(3) EXCEPTION FOR PRINCIPAL RESIDENCES.—Paragraph (1) shall not apply to any disposition of the principal residence (within the meaning of section 121) of the taxpayer .

"(b) INDEXED ASSET.—

"(1) IN GENERAL.—For purposes of this section, the term 'indexed asset' means—

"(A) common stock in a C corporation (other than a foreign corporation), and

"(B) tangible property,

which is a capital asset or property used in the trade or business (as defined in section 1231(b)).

"(2) STOCK IN CERTAIN FOREIGN CORPORATIONS INCLUDED.—For purposes of this section—

"(A) IN GENERAL.—The term 'indexed asset' includes common stock in a foreign corporation which is regularly traded on an established securities market.

"(B) EXCEPTION.—Subparagraph (A) shall not apply to—

"(i) stock of a foreign investment company (within the meaning of section 1246(b)),

"(ii) stock in a passive foreign investment company (as defined in section 1296),

"(iii) stock in a foreign corporation held by a United States person who meets the requirements of section 1248(a)(2), and

"(iv) stock in a foreign personal holding company (as defined in section 552).

"(C) TREATMENT OF AMERICAN DEPOSITORY RECEIPTS.—An American depository receipt for common stock in a foreign corporation shall be treated as common stock in such corporation.

"(c) INDEXED BASIS.—For purposes of this section—

"(1) GENERAL RULE.—The indexed basis for any asset is—

"(A) the adjusted basis of the asset, increased by

"(B) the applicable inflation adjustment.

"(2) APPLICABLE INFLATION ADJUSTMENT.—The applicable inflation adjustment for any asset is an amount equal to—

"(A) the adjusted basis of the asset, multiplied by

"(B) the percentage (if any) by which—

"(i) the chain-type price index for GDP for the last calendar quarter ending before the asset is disposed of, exceeds

"(ii) the chain-type price index for GDP for the last calendar quarter ending before the asset was acquired by the taxpayer.

The percentage under subparagraph (B) shall be rounded to the nearest 1/10 of 1 percentage point.

"(3) CHAIN-TYPE PRICE INDEX FOR GDP.—The chain-type price index for GDP for any calendar quarter is such index for such quarter (as shown in the last revision thereof released by the Secretary of Commerce before the close of the following calendar quarter).

"(d) SUSPENSION OF HOLDING PERIOD WHERE DIMINISHED RISK OF LOSS; TREATMENT OF SHORT SALES.—

"(1) IN GENERAL.—If the taxpayer (or a related person) enters into any transaction which substantially reduces the risk of loss from holding any asset, such asset shall not be treated as an indexed asset for the period of such reduced risk.

"(2) SHORT SALES.—

"(A) IN GENERAL.—In the case of a short sale of an indexed asset with a short sale period in excess of 1 year, for purposes of this title, the amount realized shall be an amount equal to the amount realized (determined without regard to this paragraph) increased by the applicable inflation adjustment. In applying subsection (c)(2) for purposes of the preceding sentence, the date on which the property is sold short shall be treated as the date of acquisition and

the closing date for the sale shall be treated as the date of disposition.

"(B) SHORT SALE PERIOD.—For purposes of subparagraph (A), the short sale period begins on the day that the property is sold and ends on the closing date for the sale.

"(e) TREATMENT OF REGULATED INVESTMENT COMPANIES AND REAL ESTATE INVESTMENT TRUSTS.—

"(1) ADJUSTMENTS AT ENTITY LEVEL.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the adjustment under subsection (a) shall be allowed to any qualified investment entity (including for purposes of determining the earnings and profits of such entity).

"(B) EXCEPTION FOR CORPORATE SHAREHOLDERS.—Under regulations—

"(i) in the case of a distribution by a qualified investment entity (directly or indirectly) to a corporation—

"(I) the determination of whether such distribution is a dividend shall be made without regard to this section, and

"(II) the amount treated as gain by reason of the receipt of any capital gain dividend shall be increased by the percentage by which the entity's net capital gain for the taxable year (determined without regard to this section) exceeds the entity's net capital gain for such year determined with regard to this section, and

"(ii) there shall be other appropriate adjustments (including deemed distributions) so as to ensure that the benefits of this section are not allowed (directly or indirectly) to corporate shareholders of qualified investment entities.

For purposes of the preceding sentence, any amount includible in gross income under section 852(b)(3)(D) shall be treated as a capital gain dividend and an S corporation shall not be treated as a corporation.

"(C) EXCEPTION FOR QUALIFICATION PURPOSES.—This section shall not apply for purposes of sections 851(b) and 856(c).

"(D) EXCEPTION FOR CERTAIN TAXES IMPOSED AT ENTITY LEVEL.—

"(i) TAX ON FAILURE TO DISTRIBUTE ENTIRE GAIN.—If any amount is subject to tax under section 852(b)(3)(A) for any taxable year, the amount on which tax is imposed under such section shall be increased by the percentage determined under subparagraph (B)(i)(II). A similar rule shall apply in the case of any amount subject to tax under paragraph (2) or (3) of section 857(b) to the extent attributable to the excess of the net capital gain over the deduction for dividends paid determined with reference to capital gain dividends only. The first sentence of this clause shall not apply to so much of the amount subject to tax under section

852(b)(3)(A) as is designated by the company under section 852(b)(3)(D).

"(ii) OTHER TAXES.—This section shall not apply for purposes of determining the amount of any tax imposed by paragraph (4), (5), or (6) of section 857(b).

"(2) ADJUSTMENTS TO INTERESTS HELD IN ENTITY.—

"(A) REGULATED INVESTMENT COMPANIES.—Stock in a regulated investment company (within the meaning of section 851) shall be an indexed asset for any calendar quarter in the same ratio as—

"(i) the average of the fair market values of the indexed assets held by such company at the close of each month during such quarter, bears to

"(ii) the average of the fair market values of all assets held by such company at the close of each such month.

"(B) REAL ESTATE INVESTMENT TRUSTS.—Stock in a real estate investment trust (within the meaning of section 856) shall be an indexed asset for any calendar quarter in the same ratio as—

"(i) the fair market value of the indexed assets held by such trust at the close of such quarter, bears to

"(ii) the fair market value of all assets held by such trust at the close of such quarter.

"(C) RATIO OF 80 PERCENT OR MORE.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 80 percent or more, such ratio for such quarter shall be 100 percent.

"(D) RATIO OF 20 PERCENT OR LESS.—If the ratio for any calendar quarter determined under subparagraph (A) or (B) would (but for this subparagraph) be 20 percent or less, such ratio for such quarter shall be zero.

"(E) LOOK-THRU OF PARTNERSHIPS.—For purposes of this paragraph, a qualified investment entity which holds a partnership interest shall be treated (in lieu of holding a partnership interest) as holding its proportionate share of the assets held by the partnership.

"(3) TREATMENT OF RETURN OF CAPITAL DISTRIBUTIONS.—Except as otherwise provided by the Secretary, a distribution with respect to stock in a qualified investment entity which is not a dividend and which results in a reduction in the adjusted basis of such stock shall be treated as allocable to stock acquired by the taxpayer in the order in which such stock was acquired.

"(4) QUALIFIED INVESTMENT ENTITY.—For purposes of this subsection, the term 'qualified investment entity' means—

"(A) a regulated investment company (within the meaning of section 851), and

"(B) a real estate investment trust (within the meaning of section 856).

"(f) OTHER PASS-THRU ENTITIES.—

"(1) PARTNERSHIPS.—

"(A) IN GENERAL.—In the case of a partnership, the adjustment made under subsection (a) at the partnership level shall be passed through to the partners.

"(B) SPECIAL RULE IN THE CASE OF SECTION 754 ELECTIONS.—In the case of a transfer of an interest in a partnership with respect to which the election provided in section 754 is in effect—

"(i) the adjustment under section 743(b)(1) shall, with respect to the transferor partner, be treated as a sale of the partnership assets for purposes of applying this section, and

"(ii) with respect to the transferee partner, the partnership's holding period for purposes of this section in such assets shall be treated as beginning on the date of such adjustment.

"(2) S CORPORATIONS.—In the case of an S corporation, the adjustment made under subsection (a) at the corporate level shall be passed through to the shareholders. This section shall not apply for purposes of determining the amount of any tax imposed by section 1374 or 1375.

"(3) COMMON TRUST FUNDS.—In the case of a common trust fund, the adjustment made under subsection (a) at the trust level shall be passed through to the participants.

"(4) INDEXING ADJUSTMENT DISREGARDED IN DETERMINING LOSS ON SALE OF INTEREST IN ENTITY.—Notwithstanding the preceding provisions of this subsection, for purposes of determining the amount of any loss on a sale or exchange of an interest in a partnership, S corporation, or common trust fund, the adjustment made under subsection (a) shall not be taken into account in determining the adjusted basis of such interest.

"(g) DISPOSITIONS BETWEEN RELATED PERSONS.—

"(1) IN GENERAL.—This section shall not apply to any sale or other disposition of property between related persons except to the extent that the basis of such property in the hands of the transferee is a substituted basis.

"(2) RELATED PERSONS DEFINED.—For purposes of this section, the term 'related persons' means—

"(A) persons bearing a relationship set forth in section 267(b), and

"(B) persons treated as single employer under subsection (b) or (c) of section 414.

"(h) TRANSFERS TO INCREASE INDEXING ADJUSTMENT.—If any person transfers cash, debt, or any other property to another person and the principal purpose of such transfer is to secure or increase an adjustment under subsection (a), the Secretary may disallow part or all of such adjustment or increase.

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

"(1) TREATMENT OF IMPROVEMENTS, ETC.—If there is an addition to the adjusted basis of any tangible property or of any stock in a corporation during the taxable year by reason of an improvement to such property or a contribution to capital of such corporation—

"(A) such addition shall never be taken into account under subsection (c)(1)(A) if the aggregate amount thereof

during the taxable year with respect to such property or stock is less than $1,000, and

"(B) such addition shall be treated as a separate asset acquired at the close of such taxable year if the aggregate amount thereof during the taxable year with respect to such property or stock is $1,000 or more.

A rule similar to the rule of the preceding sentence shall apply to any other portion of an asset to the extent that separate treatment of such portion is appropriate to carry out the purposes of this section.

"(2) ASSETS WHICH ARE NOT INDEXED ASSETS THROUGHOUT HOLDING PERIOD.—The applicable inflation adjustment shall be appropriately reduced for periods during which the asset was not an indexed asset.

"(3) TREATMENT OF CERTAIN DISTRIBUTIONS.—A distribution with respect to stock in a corporation which is not a dividend shall be treated as a disposition.

"(4) ACQUISITION DATE WHERE THERE HAS BEEN PRIOR APPLICATION OF SUBSECTION (a)(1) WITH RESPECT TO THE TAXPAYER.—If there has been a prior application of subsection (a)(1) to an asset while such asset was held by the taxpayer, the date of acquisition of such asset by the taxpayer shall be treated as not earlier than the date of the most recent such prior application.

"(5) COLLAPSIBLE CORPORATIONS.—The application of section 341(a) (relating to collapsible corporations) shall be determined without regard to this section.

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

(b) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of chapter 1 is amended by inserting after the item relating to section 1021 the following new item:

"Sec. 1022. Indexing of certain assets acquired after December 31, 1999, for purposes of determining gain.".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to the disposition of any property the holding period of which begins after December 31, 1999.

(2) CERTAIN TRANSACTIONS BETWEEN RELATED PERSONS.—The amendments made by this section shall not apply to the disposition of any property acquired after December 31, 1999, from a related person (as defined in section 1022(g)(2) of the Internal Revenue Code of 1986, as added by this section) if—

(A) such property was so acquired for a price less than the property's fair market value, and

(B) the amendments made by this section did not apply to such property in the hands of such related person.

(d) ELECTION TO RECOGNIZE GAIN ON ASSETS HELD ON JANUARY 1, 2000.—For purposes of the Internal Revenue Code of 1986—

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

(A) any readily tradable stock (which is an indexed asset) held by such taxpayer on January 1, 2000, and not

sold before the next business day after such date, as having been sold on such next business day for an amount equal to its closing market price on such next business day (and as having been reacquired on such next business day for an amount equal to such closing market price), and

(B) any other indexed asset held by the taxpayer on January 1, 2000, as having been sold on such date for an amount equal to its fair market value on such date (and as having been reacquired on such date for an amount equal to such fair market value).

(2) TREATMENT OF GAIN OR LOSS.—

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

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

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

(4) READILY TRADABLE STOCK.—For purposes of this subsection, the term "readily tradable stock" means any stock which, as of January 1, 2000, is readily tradable on an established securities market or otherwise.

SEC. 203. CAPITAL GAINS TAX RATES APPLIED TO CAPITAL GAINS OF DESIGNATED SETTLEMENT FUNDS.

(a) IN GENERAL.—Paragraph (1) of section 468B(b) (relating to taxation of designated settlement funds) is amended by inserting "(subject to section 1(h))" after "maximum rate".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 204. SPECIAL RULE FOR MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE, AND OTHER EMPLOYEES, 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 paragraphs:

"(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 Refund and Relief Act of 1999.

"(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 Refund and Relief Act of 1999.

"(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.

"(10) OTHER EMPLOYEES.—

"(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 as an employee for a period in excess of 90 days in an assignment by such employee's employer outside the United States.

"(B) LIMITATIONS AND SPECIAL RULES.—

"(i) MAXIMUM PERIOD OF SUSPENSION.—The suspension under subparagraph (A) with respect to a principal residence shall not exceed (in the aggregate) 5 years.

"(ii) MEMBERS OF UNIFORMED SERVICES AND FOREIGN SERVICE.—Subparagraph (A) shall not apply to an individual to whom paragraph (9) applies.

"(iii) SELF-EMPLOYED INDIVIDUAL NOT CONSIDERED AN EMPLOYEE.—For purposes of this paragraph, the term 'employee' does not include an individual who is an employee within the meaning of section 401(c)(1) (relating to self-employed individuals).".

(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. 205. TAX TREATMENT OF INCOME AND LOSS ON DERIVATIVES.

(a) IN GENERAL.—Section 1221 (defining capital assets) is amended—

(1) by striking "For purposes" and inserting the following: "(a) IN GENERAL.—For purposes",

(2) by striking the period at the end of paragraph (5) and inserting a semicolon, and

(3) by adding at the end the following:

"(6) any commodities derivative financial instrument held by a commodities derivatives dealer, unless—

"(A) it is established to the satisfaction of the Secretary that such instrument has no connection to the activities of such dealer as a dealer, and

"(B) such instrument is clearly identified in such dealer's records as being described in subparagraph (A) before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe);

"(7) any hedging transaction which is clearly identified as such before the close of the day on which it was acquired, originated, or entered into (or such other time as the Secretary may by regulations prescribe); or

"(8) supplies of a type regularly used or consumed by the taxpayer in the ordinary course of a trade or business of the taxpayer.

"(b) DEFINITIONS AND SPECIAL RULES.—

"(1) COMMODITIES DERIVATIVE FINANCIAL INSTRUMENTS.—For purposes of subsection (a)(6)—

"(A) COMMODITIES DERIVATIVES DEALER.—The term 'commodities derivatives dealer' means a person which regularly offers to enter into, assume, offset, assign, or terminate positions in commodities derivative financial instruments with customers in the ordinary course of a trade or business.

"(B) COMMODITIES DERIVATIVE FINANCIAL INSTRUMENT.—

"(i) IN GENERAL.—The term 'commodities derivative financial instrument' means any contract or financial instrument with respect to commodities (other than a share of stock in a corporation, a beneficial interest in a partnership or trust, a note, bond, debenture, or other evidence of indebtedness, or a section 1256 contract (as defined in section 1256(b)), the value or settlement price of which is calculated by or determined by reference to a specified index.

"(ii) SPECIFIED INDEX.—The term 'specified index' means any one or more or any combination of—

"(I) a fixed rate, price, or amount, or

"(II) a variable rate, price, or amount,

which is based on any current, objectively determinable financial or economic information with respect to commodities which is not within the control of any of the parties to the contract or instrument and is not unique to any of the parties' circumstances.

"(2) HEDGING TRANSACTION.—

"(A) IN GENERAL.—For purposes of this section, the term 'hedging transaction' means any transaction entered into by the taxpayer in the normal course of the taxpayer's trade or business primarily—

"(i) to manage risk of price changes or currency fluctuations with respect to ordinary property which is held or to be held by the taxpayer,

"(ii) to manage risk of interest rate or price changes or currency fluctuations with respect to bor-

rowings made or to be made, or ordinary obligations incurred or to be incurred, by the taxpayer, or

"(iii) to manage such other risks as the Secretary may prescribe in regulations.

"(B) TREATMENT OF NONIDENTIFICATION OR IMPROPER IDENTIFICATION OF HEDGING TRANSACTIONS.—Notwithstanding subsection (a)(7), the Secretary shall prescribe regulations to properly characterize any income, gain, expense, or loss arising from a transaction—

"(i) which is a hedging transaction but which was not identified as such in accordance with subsection (a)(7), or

"(ii) which was so identified but is not a hedging transaction.

"(3) REGULATIONS.—The Secretary shall prescribe such regulations as are appropriate to carry out the purposes of paragraph (6) and (7) of subsection (a) in the case of transactions involving related parties.".

(b) MANAGEMENT OF RISK.—

(1) Section 475(c)(3) is amended by striking "reduces" and inserting "manages".

(2) Section 871(h)(4)(C)(iv) is amended by striking "to reduce" and inserting "to manage".

(3) Clauses (i) and (ii) of section 988(d)(2)(A) are each amended by striking "to reduce" and inserting "to manage".

(4) Paragraph (2) of section 1256(e) is amended to read as follows:

"(2) DEFINITION OF HEDGING TRANSACTION.—For purposes of this subsection, the term 'hedging transaction' means any hedging transaction (as defined in section 1221(b)(2)(A)) if, before the close of the day on which such transaction was entered into (or such earlier time as the Secretary may prescribe by regulations), the taxpayer clearly identifies such transaction as being a hedging transaction.".

(c) CONFORMING AMENDMENTS.—

(1) Each of the following sections are amended by striking "section 1221" and inserting "section 1221(a)":

(A) Section 170(e)(3)(A).
(B) Section 170(e)(4)(B).
(C) Section 367(a)(3)(B)(i).
(D) Section 818(c)(3).
(E) Section 865(i)(1).
(F) Section 1092(a)(3)(B)(ii)(II).
(G) Subparagraphs (C) and (D) of section 1231(b)(1).
(H) Section 1234(a)(3)(A).

(2) Each of the following sections are amended by striking "section 1221(1)" and inserting "section 1221(a)(1)":

(A) Section 198(c)(1)(A)(i).
(B) Section 263A(b)(2)(A).
(C) Clauses (i) and (iii) of section 267(f)(3)(B).
(D) Section 341(d)(3).
(E) Section 543(a)(1)(D)(i).
(F) Section 751(d)(1).
(G) Section 775(c).

(H) Section 856(c)(2)(D).
(I) Section 856(c)(3)(C).
(J) Section 856(e)(1).
(K) Section 856(j)(2)(B).
(L) Section 857(b)(4)(B)(i).
(M) Section 857(b)(6)(B)(iii).
(N) Section 864(c)(4)(B)(iii).
(O) Section 864(d)(3)(A).
(P) Section 864(d)(6)(A).
(Q) Section 954(c)(1)(B)(iii).
(R) Section 995(b)(1)(C).
(S) Section 1017(b)(3)(E)(i).
(T) Section 1362(d)(3)(C)(ii).
(U) Section 4662(c)(2)(C).
(V) Section 7704(c)(3).
(W) Section 7704(d)(1)(D).
(X) Section 7704(d)(1)(G).
(Y) Section 7704(d)(5).

(3) Section 818(b)(2) is amended by striking "section 1221(2)" and inserting "section 1221(a)(2)".

(4) Section 1397B(e)(2) is amended by striking "section 1221(4)" and inserting "section 1221(a)(4)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after the date of enactment of this Act.

SEC. 206. WORTHLESS SECURITIES OF FINANCIAL INSTITUTIONS.

(a) IN GENERAL.—The first sentence following section 165(g)(3)(B) (relating to securities of affiliated corporation) is amended to read as follows: "In computing gross receipts for purposes of the preceding sentence, (i) gross receipts from sales or exchanges of stocks and securities shall be taken into account only to the extent of gains therefrom, and (ii) gross receipts from royalties, rents, dividends, interest, annuities, and gains from sales or exchanges of stocks and securities derived from (or directly related to) the conduct of an active trade or business of an insurance company subject to tax under subchapter L or a qualified financial institution (as defined in subsection (l)(3)) shall be treated as from such sources other than royalties, rents, dividends, interest, annuities, and gains.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to securities which become worthless in taxable years beginning after December 31, 1999.

Subtitle B—Individual Retirement Arrangements

SEC. 211. MODIFICATION OF DEDUCTION LIMITS FOR IRA CONTRIBUTIONS.

(a) INCREASE IN CONTRIBUTION LIMIT.—

(1) IN GENERAL.—Paragraph (1)(A) of section 219(b) (relating to maximum amount of deduction) is amended by striking "$2,000" and inserting "the deductible amount".

(2) DEDUCTIBLE AMOUNT.—Section 219(b) is amended by adding at the end the following new paragraph:

"(5) DEDUCTIBLE AMOUNT.—For purposes of paragraph (1)(A)—

"(A) IN GENERAL.—The deductible amount shall be determined in accordance with the following table:

"For taxable years beginning in:	***The deductible amount is:***
512001, 2002, and 2003	*$3,000*
2004 and 2005	*$4,000*
2006 and thereafter	*$5,000.*

"(B) COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2006, the $5,000 amount under subparagraph (A) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2005' for 'calendar year 1992' in subparagraph (B) thereof.

"(ii) ROUNDING RULES.—If any amount after adjustment under clause (i) is not a multiple of $100, such amount shall be rounded to the next lower multiple of $100.".

(b) CONFORMING AMENDMENTS.—

(1) Section 408(a)(1) is amended by striking "in excess of $2,000 on behalf of any individual" and inserting "on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A)".

(2) Section 408(b)(2)(B) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(3) Section 408(b) is amended by striking "$2,000" in the matter following paragraph (4) and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(4) Section 408(j) is amended by striking "$2,000".

(5) Section 408(p)(8) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 212. MODIFICATION OF INCOME LIMITS ON CONTRIBUTIONS AND ROLLOVERS TO ROTH IRAS.

(a) REPEAL OF AGI LIMIT ON CONTRIBUTIONS.—Section 408A(c)(3) (relating to limits based on modified adjusted gross income) is amended—

(1) by striking clause (ii) of subparagraph (A) and inserting:

"(ii) $10,000.", and

(2) by striking clause (ii) of subparagraph (C) and inserting:

"(ii) the applicable dollar amount is—

"(I) $200,000 in the case of a taxpayer filing a joint return, and

"(II) $100,000 in the case of any other taxpayer."

(b) INCREASE IN AGI LIMIT FOR ROLLOVER CONTRIBUTIONS.—Section 408A(c)(3)(B) (relating to rollover from IRA) is amended to read as follows:

"(B) ROLLOVER FROM IRA.—A taxpayer shall not be allowed to make a qualified rollover contribution from an individual retirement plan other than a Roth IRA during any taxable year if, for the taxable year of the distribution to which the contribution relates, the taxpayer's adjusted gross income exceeds $100,000 ($200,000 in the case of a taxpayer filing a joint return)."

(c) EFFECTIVE DATES.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 213. DEEMED IRAS UNDER EMPLOYER PLANS.

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

"(q) DEEMED IRAS UNDER QUALIFIED EMPLOYER PLANS.—

"(1) GENERAL RULE.—If—

"(A) a qualified employer plan elects to allow employees to make voluntary employee contributions to a separate account or annuity established under the plan, and

"(B) under the terms of the qualified employer plan, such account or annuity meets the applicable requirements of this section or section 408A for an individual retirement account or annuity,

then such account or annuity shall be treated for purposes of this title in the same manner as an individual retirement plan (and contributions to such account or annuity as contributions to an individual retirement plan). For purposes of subparagraph (B), the requirements of subsection (a)(5) shall not apply.

"(2) SPECIAL RULES FOR QUALIFIED EMPLOYER PLANS.—For purposes of this title—

"(A) a qualified employer plan shall not fail to meet any requirement of this title solely by reason of establishing and maintaining a program described in paragraph (1), and

"(B) any account or annuity described in paragraph (1), and any contribution to the account or annuity, shall not be subject to any requirement of this title applicable to a qualified employer plan or taken into account in applying any such requirement to any other contributions under the plan.

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

"(A) QUALIFIED EMPLOYER PLAN.—The term 'qualified employer plan' has the meaning given such term by section 72(p)(4).

"(B) VOLUNTARY EMPLOYEE CONTRIBUTION.—The term 'voluntary employee contribution' means any contribution

(other than a mandatory contribution within the meaning of section 411(c)(2)(C))—

"(i) which is made by an individual as an employee under a qualified employer plan which allows employees to elect to make contributions described in paragraph (1), and

"(ii) with respect to which the individual has designated the contribution as a contribution to which this subsection applies.".

(b) AMENDMENT OF ERISA.—

(1) IN GENERAL.—Section 4 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1003) is amended by adding at the end the following new subsection:

"(c) If a pension plan allows an employee to elect to make voluntary employee contributions to accounts and annuities as provided in section 408(q) of the Internal Revenue Code of 1986, such accounts and annuities (and contributions thereto) shall not be treated as part of such plan (or as a separate pension plan) for purposes of any provision of this title other than section 403(c), 404, or 405 (relating to exclusive benefit, and fiduciary and co-fiduciary responsibilities).".

(2) CONFORMING AMENDMENT.—Section 4(a) of such Act (29 U.S.C. 1003(a)) is amended by inserting "or (c)" after "subsection (b)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 1999.

SEC. 214. CATCHUP CONTRIBUTIONS TO IRAS BY INDIVIDUALS AGE 50 OR OVER.

(a) IN GENERAL.—Section 219(b), as amended by section 211, is amended by adding at the end the following new paragraph:

"(6) CATCHUP CONTRIBUTIONS.—

"(A) IN GENERAL.—In the case of an individual who has attained the age of 50 before the close of the taxable year, the dollar amount in effect under paragraph (1)(A) for such taxable year shall be equal to the applicable percentage of such amount determined without regard to this paragraph.

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in:	***The applicable percentage is:***
2001	*110 percent*
2002	*120 percent*
2003	*130 percent*
2004	*140 percent*
2005 and thereafter	*150percent.".*

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions in taxable years beginning after December 31, 2000.

TITLE III—ALTERNATIVE MINIMUM TAX REFORM

SEC. 301. MODIFICATION OF ALTERNATIVE MINIMUM TAX ON CORPORATIONS.

(a) LIMITATION ON USE OF CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.—Subsection (c) of section 53, as amended by section 121, is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2) CORPORATIONS FOR TAXABLE YEARS BEGINNING AFTER 2004.—In the case of a corporation for any taxable year beginning after 2004, the limitation under paragraph (1) shall be increased by the lesser of—

"(A) 50 percent of the tentative minimum tax for the taxable year, or

"(B) the excess (if any) of the tentative minimum tax for the taxable year over the regular tax for the taxable year."

(b) REPEAL OF 90 PERCENT LIMITATION ON NOL DEDUCTION.—Section 56(d)(1)(A) is amended by striking "90 percent" and inserting "90 percent (100 percent in the case of a corporation)".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2004.

(2) SUBSECTION (b).—The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 2001.

SEC. 302. REPEAL OF 90 PERCENT LIMITATION ON FOREIGN TAX CREDIT.

(a) IN GENERAL.—Section 59(a) (relating to alternative minimum tax foreign tax credit) is amended by striking paragraph (2) and by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(b) CONFORMING AMENDMENT.—Section 53(d)(1)(B)(i)(II) is amended by striking "and if section 59(a)(2) did not apply".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

TITLE IV—EDUCATION SAVINGS INCENTIVES

SEC. 401. MODIFICATIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) MAXIMUM ANNUAL CONTRIBUTIONS.—

(1) IN GENERAL.—Section 530(b)(1)(A)(iii) (defining education individual retirement account) is amended by striking "$500" and inserting "$2,000".

(2) CONFORMING AMENDMENT.—Section 4973(e)(1)(A) is amended by striking "$500" and inserting "$2,000".

(b) TAX-FREE EXPENDITURES FOR ELEMENTARY AND SECONDARY SCHOOL EXPENSES.—

(1) IN GENERAL.—Section 530(b)(2) (defining qualified higher education expenses) is amended to read as follows:

"(2) QUALIFIED EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified education expenses' means—

"(i) qualified higher education expenses (as defined in section 529(e)(3)), and

"(ii) qualified elementary and secondary education expenses (as defined in paragraph (4)).

"(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include any contribution to a qualified State tuition program (as defined in section 529(b)) on behalf of the designated beneficiary (as defined in section 529(e)(1)); 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 subsection (d)(2).".

(2) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—Section 530(b) (relating to definitions and special rules) is amended by adding at the end the following new paragraph:

"(4) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified elementary and secondary education expenses' means—

"(i) expenses for tuition, fees, academic tutoring, special needs services, books, supplies, computer equipment (including related software and services), and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary of the trust as an elementary or secondary school student at a public, private, or religious school, and

"(ii) expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance.

"(B) SPECIAL RULE FOR HOMESCHOOLING.—Such term shall include expenses described in subparagraph (A)(i) in connection with education provided by homeschooling if the requirements of any applicable State or local law are met with respect to such education.

"(C) SCHOOL.—The term 'school' means any school which provides elementary education or secondary education (kindergarten through grade 12), as determined under State law.".

(3) CONFORMING AMENDMENTS.—Section 530 is amended—

(A) by striking "higher" each place it appears in subsections (b)(1) and (d)(2), and

(B) by striking "HIGHER" in the heading for subsection (d)(2).

(c) WAIVER OF AGE LIMITATIONS FOR CHILDREN WITH SPECIAL NEEDS.—Section 530(b)(1) (defining education individual retirement

account) is amended by adding at the end the following flush sentence:

"The age limitations in subparagraphs (A)(ii) and (E) and paragraphs (5) and (6) of subsection (d) shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary).".

(d) ENTITIES PERMITTED TO CONTRIBUTE TO ACCOUNTS.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) is amended by striking "The maximum amount which a contributor" and inserting "In the case of a contributor who is an individual, the maximum amount the contributor".

(e) TIME WHEN CONTRIBUTIONS DEEMED MADE.—

(1) IN GENERAL.—Section 530(b) (relating to definitions and special rules), as amended by subsection (b)(2), is amended by adding at the end the following new paragraph:

"(5) TIME WHEN CONTRIBUTIONS DEEMED MADE.—An individual shall be deemed to have made a contribution to an education individual retirement 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).".

(2) EXTENSION OF TIME TO RETURN EXCESS CONTRIBUTIONS.—Subparagraph (C) of section 530(d)(4) (relating to additional tax for distributions not used for educational expenses) is amended—

(A) by striking clause (i) and inserting the following new clause:

"(i) such distribution is made before the 1st day of the 6th month of the taxable year following the taxable year, and", and

(B) by striking "DUE DATE OF RETURN" in the heading and inserting "CERTAIN DATE".

(f) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 530(d)(2)(C) is amended to read as follows:

"(C) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—For purposes of subparagraph (A)—

"(i) CREDIT COORDINATION.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

"(ii) COORDINATION WITH QUALIFIED TUITION PROGRAMS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions during such year to which subparagraph (A) and section 529(c)(3)(B) apply, exceed

"(II) the total amount of qualified education expenses (after the application of clause (i)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under subparagraph (A) and section 529(c)(3)(B).".

(2) CONFORMING AMENDMENTS.—

(A) Subsection (e) of section 25A is amended to read as follows:

"(e) ELECTION NOT TO HAVE SECTION APPLY.—A taxpayer may elect not to have this section apply with respect to the qualified tuition and related expenses of an individual for any taxable year.".

(B) Section 135(d)(2)(A) is amended by striking "allowable" and inserting "allowed".

(C) Section 530(d)(2)(D) is amended—

(i) by striking "or credit", and

(ii) by striking "CREDIT OR" in the heading.

(D) Section 4973(e)(1) is amended by adding "and" at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(g) RENAMING EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS AS EDUCATION SAVINGS ACCOUNTS.—

(1) IN GENERAL.—

(A) Section 530 (as amended by the preceding provisions of this section) is amended by striking "education individual retirement account" each place it appears and inserting "education savings account".

(B) The heading for paragraph (1) of section 530(b) is amended by striking "EDUCATION INDIVIDUAL RETIREMENT ACCOUNT" and inserting "EDUCATION SAVINGS ACCOUNT".

(C) The heading for section 530 is amended to read as follows:

"SEC. 530. EDUCATION SAVINGS ACCOUNTS.".

(D) The item in the table of contents for part VII of subchapter F of chapter 1 relating to section 530 is amended to read as follows:

"Sec. 530. Education savings accounts.".

(2) CONFORMING AMENDMENTS.—

(A) The following provisions are each amended by striking "education individual retirement" each place it appears and inserting "education savings":

(i) Section 25A(e)(2).

(ii) Section 26(b)(2)(E).

(iii) Section 72(e)(9).

(iv) Section 135(c)(2)(C).

(v) Subsections (a) and (e) of section 4973.

(vi) Subsections (c) and (e) of section 4975.

(vii) Section 6693(a)(2)(D).

(B) The headings for each of the following provisions are amended by striking "EDUCATION INDIVIDUAL RETIRE-

MENT ACCOUNTS" each place it appears and inserting "EDUCATION SAVINGS ACCOUNTS".

(i) Section 72(e)(9).

(ii) Section 135(c)(2)(C).

(iii) Section 4973(e).

(iv) Section 4975(c)(5).

(h) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) SUBSECTION (g).—The amendments made by subsection (g) shall take effect on the date of the enactment of this Act.

SEC. 402. MODIFICATIONS TO QUALIFIED TUITION PROGRAMS.

(a) SHORT TITLE.—This section may be cited as the "Collegiate Learning and Student Savings (CLASS) Act".

(b) ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(b)(1) (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".

(2) PRIVATE QUALIFIED TUITION PROGRAMS LIMITED TO BENEFIT PLANS.—Clause (ii) of section 529(b)(1)(A) is amended by inserting "in the case of a program established and maintained by a State or agency or instrumentality thereof," before "may make".

(3) CONFORMING AMENDMENTS.—

(A) Sections 72(e)(9), 135(c)(2)(C), 135(d)(1)(D), 529, 530(b)(2)(B), 4973(e), and 6693(a)(2)(C) are each amended by striking "qualified State tuition" each place it appears and inserting "qualified tuition".

(B) The headings for sections 72(e)(9) and 135(c)(2)(C) are each amended by striking "QUALIFIED STATE TUITION" and inserting "QUALIFIED TUITION".

(C) The headings for sections 529(b) and 530(b)(2)(B) are each amended by striking "QUALIFIED STATE TUITION" and inserting "QUALIFIED TUITION".

*(D) The heading for section 529 is amended by striking "**STATE**".*

(E) 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) EXCLUSION FROM GROSS INCOME OF EDUCATION DISTRIBUTIONS FROM QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(c)(3)(B) (relating to distributions) is amended to read as follows:

"(B) DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of this paragraph—

"(i) IN-KIND DISTRIBUTIONS.—No amount shall be includible in gross income under subparagraph (A) by reason of a distribution which consists of providing a benefit to the distributee which, if paid for by the distributee, would constitute payment of a qualified higher education expense.

"(ii) CASH DISTRIBUTIONS.—In the case of distributions not described in clause (i), if—

"(I) such distributions do not exceed the qualified higher education expenses (reduced by expenses described in clause (i)), no amount shall be includible in gross income, and

"(II) in any other case, the amount otherwise includible in gross income shall be reduced by an amount which bears the same ratio to such amount as such expenses bear to such distributions.

"(iii) EXCEPTION FOR INSTITUTIONAL PROGRAMS.—In the case of any taxable year beginning before January 1, 2004, clauses (i) and (ii) shall not apply with respect to any distribution during such taxable year under a qualified tuition program established and maintained by 1 or more eligible educational institutions.

"(iv) TREATMENT AS DISTRIBUTIONS.—Any benefit furnished to a designated beneficiary under a qualified tuition program shall be treated as a distribution to the beneficiary for purposes of this paragraph.

"(v) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

"(vi) COORDINATION WITH EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions to which clauses (i) and (ii) and section 530(d)(2)(A) apply, exceed

"(II) the total amount of qualified higher education expenses otherwise taken into account under clauses (i) and (ii) (after the application of clause (v)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under clauses (i) and (ii) and section 530(d)(2)(A).".

(2) CONFORMING AMENDMENTS.—

(A) Section 135(d)(2)(B) is amended by striking "the exclusion under section 530(d)(2)" and inserting "the exclusions under sections 529(c)(3)(B)(i) and 530(d)(2)".

(B) Section 221(e)(2)(A) is amended by inserting "529," after "135,".

(d) ROLLOVER TO DIFFERENT PROGRAM FOR BENEFIT OF SAME DESIGNATED BENEFICIARY.—Section 529(c)(3)(C) (relating to change in beneficiaries) is amended—

(1) by striking "transferred to the credit" in clause (i) and inserting "transferred—

"(I) to another qualified tuition program for the benefit of the designated beneficiary, or

"(II) to the credit",

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

"(iii) LIMITATION ON CERTAIN ROLLOVERS.—Clause (i)(I) shall not apply to any amount transferred with respect to a designated beneficiary if, at any time during the 1-year period ending on the day of such transfer, any other amount was transferred with respect to such beneficiary which was not includible in gross income by reason of clause (i)(I).", and

(3) by inserting "OR PROGRAMS" after "BENEFICIARIES" in the heading.

(e) MEMBER OF FAMILY INCLUDES FIRST COUSIN.—Section 529(e)(2) (defining member of family) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and by inserting "; and", and by adding at the end the following new subparagraph:

"(D) any first cousin of such beneficiary.".

(f) DEFINITION OF QUALIFIED HIGHER EDUCATION EXPENSES.—

(1) IN GENERAL.—Subparagraph (A) of section 529(e)(3) (relating to definition of qualified higher education expenses) is amended to read as follows:

"(A) IN GENERAL.—The term 'qualified higher education expenses' means—

"(i) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible educational institution for courses of instruction of such beneficiary at such institution, and

"(ii) expenses for books, supplies, and equipment which are incurred in connection with such enrollment or attendance, but not to exceed the allowance for books and supplies included 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 enactment of the Taxpayer Refund and Relief Act of 1999) as determined by the eligible educational institution.".

(2) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC.—Paragraph (3) of section 529(e) (relating to qualified higher education expenses) is amended by adding at the end the following new subparagraph:

"(C) EXCEPTION FOR EDUCATION INVOLVING SPORTS, ETC.—The term 'qualified higher education expenses' shall not include expenses with respect to any course or other education involving sports, games, or hobbies unless such course or other education is part of the beneficiary's degree program or is taken to acquire or improve job skills of the beneficiary.".

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

(2) QUALIFIED HIGHER EDUCATION EXPENSES.—The amendments made by subsection (f) shall apply to amounts paid for courses beginning after December 31, 1999.

SEC. 403. EXCLUSION OF CERTAIN AMOUNTS RECEIVED UNDER THE NATIONAL HEALTH SERVICE CORPS SCHOLARSHIP PROGRAM, THE F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM, AND CERTAIN OTHER PROGRAMS.

(a) IN GENERAL.—Section 117(c) (relating to the exclusion from gross income amounts received as a qualified scholarship) is amended—

(1) by striking "Subsections (a)" and inserting the following:

"(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a)", and

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

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any amount received by an individual under—

"(A) the National Health Service Corps Scholarship program under section 338A(g)(1)(A) of the Public Health Service Act,

"(B) the Armed Forces Health Professions Scholarship and Financial Assistance program under subchapter I of chapter 105 of title 10, United States Code,

"(C) the National Institutes of Health Undergraduate Scholarship program under section 487D of the Public Health Service Act, or

"(D) any State program determined by the Secretary to have substantially similar objectives as such programs.".

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by subsection (a) shall apply to amounts received in taxable years beginning after December 31, 1993.

(2) STATE PROGRAMS.—Section 117(c)(2)(D) of the Internal Revenue Code of 1986 (as added by the amendments made by subsection (a)) shall apply to amounts received in taxable years beginning after December 31, 1999.

SEC. 404. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

Section 127(d) (relating to termination of exclusion for educational assistance programs) is amended by striking "May 31, 2000" and inserting "December 31, 2003".

SEC. 405. ADDITIONAL INCREASE IN ARBITRAGE REBATE EXCEPTION FOR GOVERNMENTAL BONDS USED TO FINANCE EDUCATIONAL FACILITIES.

(a) IN GENERAL.—Section 148(f)(4)(D)(vii) (relating to increase in exception for bonds financing public school capital expenditures) is amended by striking "$5,000,000" the second place it appears and inserting "$10,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued in calendar years beginning after December 31, 1999.

SEC. 406. 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, 60 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, 1999.

SEC. 407. ELIMINATION OF 60-MONTH LIMIT AND INCREASE IN INCOME LIMITATION ON STUDENT LOAN INTEREST DEDUCTION.

(a) ELIMINATION OF 60-MONTH LIMIT.—

(1) IN GENERAL.—Section 221 (relating to interest on education loans) is amended by striking subsection (d) and by redesignating subsections (e), (f), and (g) as subsections (d), (e), and (f), respectively.

(2) CONFORMING AMENDMENT.—Section 6050S(e) is amended by striking "section 221(e)(1)" and inserting "section 221(d)(1)".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply with respect to any loan interest paid after December 31, 1999, in taxable years ending after such date.

(b) INCREASE IN INCOME LIMITATION.—

(1) IN GENERAL.—Section 221(b)(2)(B) (relating to amount of reduction) is amended by striking clauses (i) and (ii) and inserting the following:

"(i) the excess of—

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

"(II) $45,000 ($90,000 in the case of a joint return), bears to

"(ii) $15,000.".

(2) CONFORMING AMENDMENT.—Section 221(g)(1) is amended by striking "$40,000 and $60,000 amounts" and inserting "$45,000 and $90,000 amounts".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after December 31, 1999.

SEC. 408. 2-PERCENT FLOOR ON MISCELLANEOUS ITEMIZED DEDUCTIONS NOT TO APPLY TO QUALIFIED PROFESSIONAL DEVELOPMENT EXPENSES OF ELEMENTARY AND SECONDARY SCHOOL TEACHERS.

(a) IN GENERAL.—Section 67(b) (defining miscellaneous itemized deductions) is amended by striking "and" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting ", and", and by adding at the end the following new paragraph:

"(13) any deduction allowable for the qualified professional development expenses of an eligible teacher.".

(b) DEFINITIONS.—Section 67 (relating to 2-percent floor on miscellaneous itemized deductions) is amended by adding at the end the following new subsection:

"(g) QUALIFIED PROFESSIONAL DEVELOPMENT EXPENSES OF ELIGIBLE TEACHERS.—For purposes of subsection (b)(13)—

"(1) QUALIFIED PROFESSIONAL DEVELOPMENT EXPENSES.—

"(A) IN GENERAL.—The term 'qualified professional development expenses' means expenses in an amount not to exceed $1,000 for any taxable year—

"(i) for tuition, fees, books, supplies, equipment, and transportation required for the enrollment or attendance of an individual in a qualified course of instruction, and

"(ii) with respect to which a deduction is allowable under section 162 (determined without regard to this section).

"(B) QUALIFIED COURSE OF INSTRUCTION.—The term 'qualified course of instruction' means a course of instruction which—

"(i) is—

"(I) at an institution of higher education (as defined 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 subsection), or

"(II) a professional conference, and

"(ii) is part of a program of professional development which is approved and certified by the appropriate local educational agency as furthering the individual's teaching skills.

"(C) LOCAL EDUCATIONAL AGENCY.—The term 'local educational agency' has the meaning given such term by

section 14101 of the Elementary and Secondary Education Act of 1965, as so in effect.

"(2) ELIGIBLE TEACHER.—

"(A) IN GENERAL.—The term 'eligible teacher' means an individual who is a kindergarten through grade 12 classroom teacher, instructor, counselor, aide, or principal in an elementary or secondary school.

"(B) ELEMENTARY OR SECONDARY SCHOOL.—The terms 'elementary school' and 'secondary school' have the meanings given such terms by section 14101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 8801), as so in effect.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000, and ending before January 1, 2005.

TITLE V—HEALTH CARE PROVISIONS

SEC. 501. DEDUCTION FOR HEALTH AND LONG-TERM CARE INSURANCE COSTS OF INDIVIDUALS NOT PARTICIPATING IN EMPLOYER-SUBSIDIZED HEALTH PLANS.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 is amended by redesignating section 222 as section 223 and by inserting after section 221 the following new section:

"SEC. 222. HEALTH AND LONG-TERM CARE INSURANCE COSTS.

"(a) IN GENERAL.—In the case of an individual, there shall be allowed as a deduction an amount equal to the applicable percentage of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer and the taxpayer's spouse and dependents.

"(b) APPLICABLE PERCENTAGE.—For purposes of subsection (a), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2002, 2003, and 2004	*25*
2005	*35*
2006	*65*
2007 and thereafter	*100.*

"(c) LIMITATION BASED ON OTHER COVERAGE.—

"(1) COVERAGE UNDER CERTAIN SUBSIDIZED EMPLOYER PLANS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any taxpayer for any calendar month for which the taxpayer participates in any health plan maintained by any employer of the taxpayer or of the spouse of the taxpayer if 50 percent or more of the cost of coverage under such plan (determined under section 4980B and without regard to payments made with respect to any coverage described in subsection (e)) is paid or incurred by the employer.

"(B) EMPLOYER CONTRIBUTIONS TO CAFETERIA PLANS, FLEXIBLE SPENDING ARRANGEMENTS, AND MEDICAL SAVINGS ACCOUNTS.—Employer contributions to a cafeteria plan, a flexible spending or similar arrangement, or a medical sav-

ings account which are excluded from gross income under section 106 shall be treated for purposes of subparagraph (A) as paid by the employer.

"(C) AGGREGATION OF PLANS OF EMPLOYER.—A health plan which is not otherwise described in subparagraph (A) shall be treated as described in such subparagraph if such plan would be so described if all health plans of persons treated as a single employer under subsections (b), (c), (m), or (o) of section 414 were treated as one health plan.

"(D) SEPARATE APPLICATION TO HEALTH INSURANCE AND LONG-TERM CARE INSURANCE.—Subparagraphs (A) and (C) shall be applied separately with respect to—

"(i) plans which include primarily coverage for qualified long-term care services or are qualified long-term care insurance contracts, and

"(ii) plans which do not include such coverage and are not such contracts.

"(2) COVERAGE UNDER CERTAIN FEDERAL PROGRAMS.—

"(A) IN GENERAL.—Subsection (a) shall not apply to any amount paid for any coverage for an individual for any calendar month if, as of the first day of such month, the individual is covered under any medical care program described in—

"(i) title XVIII, XIX, or XXI of the Social Security Act,

"(ii) chapter 55 of title 10, United States Code,

"(iii) chapter 17 of title 38, United States Code,

"(iv) chapter 89 of title 5, United States Code, or

"(v) the Indian Health Care Improvement Act.

"(B) EXCEPTIONS.—

"(i) QUALIFIED LONG-TERM CARE.—Subparagraph (A) shall not apply to amounts paid for coverage under a qualified long-term care insurance contract.

"(ii) CONTINUATION COVERAGE OF FEHBP.—Subparagraph (A)(iv) shall not apply to coverage which is comparable to continuation coverage under section 4980B.

"(d) LONG-TERM CARE DEDUCTION LIMITED TO QUALIFIED LONG-TERM CARE INSURANCE CONTRACTS.—In the case of a qualified long-term care insurance contract, only eligible long-term care premiums (as defined in section 213(d)(10)) may be taken into account under subsection (a).

"(e) DEDUCTION NOT AVAILABLE FOR PAYMENT OF ANCILLARY COVERAGE PREMIUMS.—Any amount paid as a premium for insurance which provides for—

"(1) coverage for accidents, disability, dental care, vision care, or a specified illness, or

"(2) making payments of a fixed amount per day (or other period) by reason of being hospitalized.

shall not be taken into account under subsection (a).

"(f) SPECIAL RULES.—

"(1) COORDINATION WITH DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.—The amount taken into account by the taxpayer in computing the deduction

under section 162(l) shall not be taken into account under this section.

"(2) COORDINATION WITH MEDICAL EXPENSE DEDUCTION.—The amount taken into account by the taxpayer in computing the deduction under this section shall not be taken into account under section 213.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out this section, including regulations requiring employers to report to their employees and the Secretary such information as the Secretary determines to be appropriate.".

(b) DEDUCTION ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 is amended by inserting after paragraph (17) the following new item:

"(18) HEALTH AND LONG-TERM CARE INSURANCE COSTS.—The deduction allowed by section 222.".

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

"Sec. 222. Health and long-term care insurance costs.
"Sec. 223. Cross reference.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 502. LONG-TERM CARE INSURANCE PERMITTED TO BE OFFERED UNDER CAFETERIA PLANS AND FLEXIBLE SPENDING ARRANGEMENTS.

(a) CAFETERIA PLANS.—

(1) IN GENERAL.—Subsection (f) of section 125 (defining qualified benefits) is amended by inserting before the period at the end "; except that such term shall include the payment of premiums for any qualified long-term care insurance contract (as defined in section 7702B) to the extent the amount of such payment does not exceed the eligible long-term care premiums (as defined in section 213(d)(10)) for such contract".

(b) FLEXIBLE SPENDING ARRANGEMENTS.—Section 106 (relating to contributions by employer to accident and health plans) is amended by striking subsection (c).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 503. ADDITIONAL PERSONAL EXEMPTION FOR TAXPAYER CARING FOR ELDERLY FAMILY MEMBER IN TAXPAYER'S HOME.

(a) IN GENERAL.—Section 151 (relating to allowance of deductions for personal exemptions) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) ADDITIONAL EXEMPTION FOR CERTAIN ELDERLY FAMILY MEMBERS RESIDING WITH TAXPAYER.—

"(1) IN GENERAL.—An exemption of the exemption amount for each qualified family member of the taxpayer.

"(2) QUALIFIED FAMILY MEMBER.—For purposes of this subsection, the term 'qualified family member' means, with respect to any taxable year, any individual—

"(A) who is an ancestor of the taxpayer or of the taxpayer's spouse or who is the spouse of any such ancestor,

"(B) who is a member for the entire taxable year of a household maintained by the taxpayer, and

"(C) who has been certified, before the due date for filing the return of tax for the taxable year (without extensions), by a physician (as defined in section 1861(r)(1) of the Social Security Act) as being an individual with long-term care needs described in paragraph (3) for a period—

"(i) which is at least 180 consecutive days, and

"(ii) a portion of which occurs within the taxable year.

Such term shall not include any individual otherwise meeting the requirements of the preceding sentence unless within the 39½ month period ending on such due date (or such other period as the Secretary prescribes) a physician (as so defined) has certified that such individual meets such requirements.

"(3) INDIVIDUALS WITH LONG-TERM CARE NEEDS.—An individual is described in this paragraph if the individual—

"(A) is unable to perform (without substantial assistance from another individual) at least 2 activities of daily living (as defined in section 7702B(c)(2)(B)) due to a loss of functional capacity, or

"(B) requires substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment and is unable to perform, without reminding or cuing assistance, at least 1 activity of daily living (as so defined) or to the extent provided in regulations prescribed by the Secretary (in consultation with the Secretary of Health and Human Services), is unable to engage in age appropriate activities.

"(4) SPECIAL RULES.—Rules similar to the rules of paragraphs (1), (2), (3), (4), and (5) of section 21(e) shall apply for purposes of this subsection.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 504. EXPANDED HUMAN CLINICAL TRIALS QUALIFYING FOR ORPHAN DRUG CREDIT.

(a) IN GENERAL.—Subclause (I) of section 45C(b)(2)(A)(ii) is amended to read as follows:

"(I) after the date that the application is filed for designation under such section 526, and".

(b) CONFORMING AMENDMENT.—Clause (i) of section 45C(b)(2)(A) is amended by inserting "which is" before "being" and by inserting before the comma at the end "and which is designated under section 526 of such Act".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 1999.

SEC. 505. INCLUSION OF CERTAIN VACCINES AGAINST STREPTOCOCCUS PNEUMONIAE TO LIST OF TAXABLE VACCINES; REDUCTION IN PER DOSE TAX RATE.

(a) INCLUSION OF VACCINES.—

(1) IN GENERAL.—Section 4132(a)(1) (defining taxable vaccine) is amended by adding at the end the following new subparagraph:

"(L) Any conjugate vaccine against streptococcus pneumoniae.".

(2) EFFECTIVE DATE.—

(A) SALES.—The amendment made by this subsection shall apply to vaccine sales beginning on the day after the date on which the Centers for Disease Control makes a final recommendation for routine administration to children of any conjugate vaccine against streptococcus pneumoniae, but shall not take effect if subsection (c) does not take effect.

(B) DELIVERIES.—For purposes of subparagraph (A), in the case of sales on or before the date described in such subparagraph for which delivery is made after such date, the delivery date shall be considered the sale date.

(b) REDUCTION IN PER DOSE TAX RATE.—

(1) IN GENERAL.—Section 4131(b)(1) (relating to amount of tax) is amended by striking "75 cents" and inserting "50 cents".

(2) EFFECTIVE DATE.—

(A) SALES.—The amendment made by this subsection shall apply to vaccine sales after December 31, 2004, but shall not take effect if subsection (c) does not take effect.

(B) DELIVERIES.—For purposes of subparagraph (A), in the case of sales on or before the date described in such subparagraph for which delivery is made after such date, the delivery date shall be considered the sale date.

(3) LIMITATION ON CERTAIN CREDITS OR REFUNDS.—For purposes of applying section 4132(b) of the Internal Revenue Code of 1986 with respect to any claim for credit or refund filed after August 31, 2004, the amount of tax taken into account shall not exceed the tax computed under the rate in effect on January 1, 2005.

(c) VACCINE TAX AND TRUST FUND AMENDMENTS.—

(1) Sections 1503 and 1504 of the Vaccine Injury Compensation Program Modification Act (and the amendments made by such sections) are hereby repealed.

(2) Subparagraph (A) of section 9510(c)(1) is amended by striking "August 5, 1997" and inserting "October 21, 1998".

(3) The amendments made by this subsection shall take effect as if included in the provisions of the Tax and Trade Relief Extension Act of 1998 to which they relate.

SEC. 506. DRUG BENEFITS FOR MEDICARE BENEFICIARIES.

(a) IN GENERAL.—Section 213 (relating to medical, dental, etc., expenses) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) DRUG BENEFITS FOR MEDICARE BENEFICIARIES.—

"(1) DEDUCTION FOR CERTAIN FORMER PRESCRIPTION DRUGS.—

"(A) IN GENERAL.—Subsection (b) shall not apply to amounts paid for eligible former prescription drugs for a medicare beneficiary who is the taxpayer or the taxpayer's spouse or dependent (as defined in section 152).

"(B) ELIGIBLE FORMER PRESCRIPTION DRUG.—For purposes of subparagraph (A), the term 'eligible former pre-

scription drug' means any drug or biological which is not a prescribed drug at the time purchased by the taxpayer but was a prescribed drug at any prior time during the calendar year in which so purchased or during the 2 preceding calendar years.

"(2) ADJUSTED GROSS INCOME THRESHOLD NOT TO APPLY TO PRESCRIPTION DRUG INSURANCE COVERAGE FOR MEDICARE BENEFICIARIES IF CERTAIN CONDITIONS MET.—The 7.5 percent adjusted gross income threshold in subsection (a) shall not apply to the expenses paid during the taxable year for prescription drug insurance coverage for a medicare beneficiary who is the taxpayer or the taxpayer's spouse or dependent (as defined in section 152) if—

"(A) the Secretary certifies that, throughout such taxable year, the conditions specified in paragraph (3) are met, and

"(B) the charge for such coverage is either separately stated in the contract or furnished to the policyholder by the insurance company in a separate statement.

"(3) CONDITIONS.—For purposes of paragraph (2), the conditions specified in this paragraph are met if all of the following are in effect:

"(A) ASSISTANCE FOR PRESCRIPTION DRUGS FOR LOW-INCOME MEDICARE BENEFICIARIES.—

"(i) Low-income assistance is available to enable the purchase of coverage of prescription drugs as described in subparagraph (B) or (C) for medicare beneficiaries with incomes under 135 percent of the applicable Federal poverty level, with such assistance phasing out for beneficiaries with incomes between 135 percent and 150 percent of such level.

"(ii) The Federal Government provides funding for the costs of such assistance.

"(B) AUTHORIZING MEDIGAP COVERAGE SOLELY OF PRESCRIPTION DRUGS.—At least 1 of the benefit packages authorized to be offered under a medicare supplemental policy under the Social Security Act is a package which provides solely for the coverage of costs of prescription drugs.

"(C) STRUCTURAL MEDICARE REFORM.—Coverage for outpatient prescription drugs for medicare beneficiaries is provided only through integrated comprehensive health plans which offer current medicare covered services and maximum limitations on out-of-pocket spending and such comprehensive plans sponsored by the Health Care Financing Administration compete on the same basis as private plans.

"(D) DEDUCTION FOR ELIGIBLE FORMER PRESCRIPTION DRUGS.—The treatment under paragraph (1) of expenses paid for eligible former prescription drugs applies for such taxable year.

"(4) DEFINITION AND SPECIAL RULE.—

"(A) MEDICARE BENEFICIARY.—For purposes of this subsection, the term 'medicare beneficiary' means an indi-

vidual who is entitled to benefits under part A, or enrolled under part B or C, of title XVIII of the Social Security Act.

"(B) COORDINATION WITH OTHER EXPENSES.—Expenses to which the 7.5 percent adjusted gross income threshold in subsection (a) does not apply by reason of paragraph (1) and (2) shall not be taken into account in applying such threshold to other expenses."

(b) DEDUCTION FOR PRESCRIPTION DRUG INSURANCE COVERAGE ALLOWED WHETHER OR NOT TAXPAYER ITEMIZES OTHER DEDUCTIONS.—Subsection (a) of section 62 (defining adjusted gross income) is amended by inserting after paragraph (18) the following new paragraph:

"(19) PRESCRIPTION DRUG INSURANCE COVERAGE FOR MEDICARE BENEFICIARIES.—The deduction allowed by section 213(a) to the extent of the expenses to which the 7.5 percent adjusted gross income threshold in subsection (a) does not apply by reason of paragraph (2) of section 213(e)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

TITLE VI—ESTATE TAX RELIEF

Subtitle A—Repeal of Estate, Gift, and Generation-Skipping Taxes; Repeal of Step Up in Basis At Death

SEC. 601. REPEAL OF ESTATE, GIFT, AND GENERATION-SKIPPING TAXES.

(a) IN GENERAL.—Subtitle B is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to the estates of decedents dying, and gifts and generation-skipping transfers made, after December 31, 2008.

SEC. 602. TERMINATION OF STEP UP IN BASIS AT DEATH.

(a) TERMINATION OF APPLICATION OF SECTION 1014.—Section 1014 (relating to basis of property acquired from a decedent) is amended by adding at the end the following:

"(f) TERMINATION.—In the case of a decedent dying after December 31, 2008, this section shall not apply to property for which basis is provided by section 1023.".

(b) CONFORMING AMENDMENT.—Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking "and" at the end of paragraph (26), by striking the period at the end of paragraph (27) and inserting "; and", and by adding at the end the following:

"(28) to the extent provided in section 1023 (relating to basis for certain property acquired from a decedent dying after December 31, 2008).".

SEC. 603. CARRYOVER BASIS AT DEATH.

(a) GENERAL RULE.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1022, as added by section 202, the following:

"SEC. 1023. CARRYOVER BASIS FOR CERTAIN PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2008.

"(a) CARRYOVER BASIS.—Except as otherwise provided in this section, the basis of carryover basis property in the hands of a person acquiring such property from a decedent shall be determined under section 1015.

"(b) CARRYOVER BASIS PROPERTY DEFINED.—

"(1) IN GENERAL.—For purposes of this section, the term 'carryover basis property' means any property—

"(A) which is acquired from or passed from a decedent who died after December 31, 2008, and

"(B) which is not excluded pursuant to paragraph (2). The property taken into account under subparagraph (A) shall be determined under section 1014(b) without regard to subparagraph (A) of the last sentence of paragraph (9) thereof.

"(2) CERTAIN PROPERTY NOT CARRYOVER BASIS PROPERTY.—The term 'carryover basis property' does not include—

"(A) any item of gross income in respect of a decedent described in section 691,

"(B) property which was acquired from the decedent by the surviving spouse of the decedent but only if the value of such property would have been deductible from the value of the taxable estate of the decedent under section 2056, as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999, and

"(C) any includible property of the decedent if the aggregate adjusted fair market value of such property does not exceed $2,000,000.

For purposes of this subsection, the term 'adjusted fair market value' means, with respect to any property, fair market value reduced by any indebtedness secured by such property.

"(3) LIMITATION ON EXCEPTION FOR PROPERTY ACQUIRED BY SURVIVING SPOUSE.—The adjusted fair market value of property which is not carryover basis property by reason of paragraph (2)(B) shall not exceed $3,000,000. The executor shall allocate the limitation under the preceding sentence among such property.

"(4) PHASEIN OF CARRYOVER BASIS IF PROPERTY EXCEEDS $1,300,000.—

"(A) IN GENERAL.—If the aggregate adjusted fair market value of the includible property of the decedent exceeds $1,300,000, but does not exceed $2,000,000, the amount of the increase in the basis of includible property which would (but for this paragraph) result under section 1014 shall be reduced by the amount which bears the same ratio to such increase as such excess bears to $700,000.

"(B) ALLOCATION OF REDUCTION.—The reduction under subparagraph (A) shall be allocated among only the excepted includible property having net appreciation and shall be allocated in proportion to the respective amounts of such net appreciation. For purposes of the preceding sentence, the term 'net appreciation' means the excess of the adjusted fair market value over the decedent's adjusted basis immediately before such decedent's death.

"(5) INCLUDIBLE PROPERTY.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'includible property' means property which would be included in the gross estate of the decedent under any of the following provisions as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999:

"(i) Section 2033.
"(ii) Section 2038.
"(iii) Section 2040.
"(iv) Section 2041.
"(v) Section 2042(1).

"(B) EXCLUSION OF PROPERTY ACQUIRED BY SPOUSE.—Such term shall not include property which is not carryover basis property by reason of paragraph (2)(B).

"(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.".

(b) MISCELLANEOUS AMENDMENTS RELATED TO CARRYOVER BASIS.—

(1) CAPITAL GAIN TREATMENT FOR INHERITED ART WORK OR SIMILAR PROPERTY.—

(A) IN GENERAL.—Subparagraph (C) of section 1221(3) (defining capital asset) is amended by inserting "(other than by reason of section 1023)" after "is determined".

(B) COORDINATION WITH SECTION 170.—Paragraph (1) of section 170(e) (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end the following: "For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(3)(C) for basis determined under section 1023.".

(2) DEFINITION OF EXECUTOR.—Section 7701(a) (relating to definitions) is amended by adding at the end the following:

"(47) EXECUTOR.—The term 'executor' means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.".

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

"Sec. 1023. Carryover basis for certain property acquired from a decedent dying after December 31, 2008.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2008.

Subtitle B—Reductions of Estate and Gift Tax Rates Prior to Repeal

SEC. 611. ADDITIONAL REDUCTIONS OF ESTATE AND GIFT TAX RATES.

(a) MAXIMUM RATE OF TAX REDUCED TO 50 PERCENT.—

(1) IN GENERAL.—The table contained in section 2001(c)(1) is amended by striking the 2 highest brackets and inserting the following:

"Over $2,500,000	*$1,025,800, plus 50% of the excess over $2,500,000.".*

(2) PHASE-IN OF REDUCED RATE.—Subsection (c) of section 2001 is amended by adding at the end the following new paragraph:

"(3) PHASE-IN OF REDUCED RATE.—In the case of decedents dying, and gifts made, during 2001, the last item in the table contained in paragraph (1) shall be applied by substituting '53%' for '50%'.".

(b) REPEAL OF PHASEOUT OF GRADUATED RATES.—Subsection (c) of section 2001 is amended by striking paragraph (2) and redesignating paragraph (3), as added by subsection (a), as paragraph (2).

(c) ADDITIONAL REDUCTIONS OF RATES OF TAX.—Subsection (c) of section 2001, as so amended, is amended by adding at the end the following new paragraph:

"(3) PHASEDOWN OF TAX.—In the case of estates of decedents dying, and gifts made, during any calendar year after 2004 and before 2009—

"(A) IN GENERAL.—Except as provided in subparagraph (C), the tentative tax under this subsection shall be determined by using a table prescribed by the Secretary (in lieu of using the table contained in paragraph (1)) which is the same as such table; except that—

"(i) each of the rates of tax shall be reduced by the number of percentage points determined under subparagraph (B), and

"(ii) the amounts setting forth the tax shall be adjusted to the extent necessary to reflect the adjustments under clause (i).

"(B) PERCENTAGE POINTS OF REDUCTION.—

"For calendar year:	***The number of percentage points is:***
2003	*1.0*
2004	*2.0*
2005	*3.0*
2006	*4.0*
2007	*5.5*
2008	*7.5.*

"(C) COORDINATION WITH INCOME TAX RATES.—The reductions under subparagraph (A)—

"(i) shall not reduce any rate under paragraph (1) below the lowest rate in section 1(c), and

"(ii) shall not reduce the highest rate under paragraph (1) below the highest rate in section 1(c).

"(D) COORDINATION WITH CREDIT FOR STATE DEATH TAXES.—Rules similar to the rules of subparagraph (A) shall apply to the table contained in section 2011(b) except that the Secretary shall prescribe percentage point reductions which maintain the proportionate relationship (as in effect before any reduction under this paragraph) between

the credit under section 2011 and the tax rates under subsection (c).".

(d) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) and (b).—The amendments made by subsections (a) and (b) shall apply to estates of decedents dying, and gifts made, after December 31, 2000.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to estates of decedents dying, and gifts made, after December 31, 2004.

Subtitle C—Unified Credit Replaced With Unified Exemption Amount

SEC. 621. UNIFIED CREDIT AGAINST ESTATE AND GIFT TAXES REPLACED WITH UNIFIED EXEMPTION AMOUNT.

(a) IN GENERAL.—

(1) ESTATE TAX.—Part IV of subchapter A of chapter 11 is amended by inserting after section 2051 the following new section:

"SEC. 2052. EXEMPTION.

"(a) IN GENERAL.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the excess (if any) of—

"(1) the exemption amount for the calendar year in which the decedent died, over

"(2) the sum of—

"(A) the aggregate amount allowed as an exemption under section 2521 with respect to gifts made by the decedent after December 31, 2000, and

"(B) the aggregate amount of gifts made by the decedent for which credit was allowed by section 2505 (as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999).

Gifts which are includible in the gross estate of the decedent shall not be taken into account in determining the amounts under paragraph (2).

"(b) EXEMPTION AMOUNT.—For purposes of subsection (a), the term 'exemption amount' means the amount determined in accordance with the following table:

"In the case of calendar year:	***The exemption amount is:***
2001	*$675,000*
2002 and 2003	*$700,000*
2004	*$850,000*
2005	*$950,000*
2006 or thereafter	*$1,000,000."*

(2) GIFT TAX.—Subchapter C of chapter 12 (relating to deductions) is amended by inserting before section 2522 the following new section:

"SEC. 2521. EXEMPTION.

"In computing taxable gifts for any calendar year, there shall be allowed as a deduction in the case of a citizen or resident of the United States an amount equal to the excess of—

"(1) the exemption amount determined under section 2052 for such calendar year, over

"(2) the sum of—

"(A) the aggregate amount allowed as an exemption under this section for all preceding calendar years after 2000, and

"(B) the aggregate amount of gifts for which credit was allowed by section 2505 (as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999)."

(b) REPEAL OF UNIFIED CREDITS.—

(1) Section 2010 (relating to unified credit against estate tax) is hereby repealed.

(2) Section 2505 (relating to unified credit against gift tax) is hereby repealed.

(c) CONFORMING AMENDMENTS.—

(1) Subparagraph (B) of section 2001(b)(1) is amended by inserting before the comma "reduced by the amount described in section 2052(a)(2)(B)".

(2)(A) Subsection (b) of section 2011 is amended—

(i) by striking "adjusted" in the table, and

(ii) by striking the last sentence.

(B) Subsection (f) of section 2011 is amended by striking ", reduced by the amount of the unified credit provided by section 2010".

(3) Subsection (a) of section 2012 is amended by striking "and the unified credit provided by section 2010".

(4)(A) Subsection (b) of section 2013 is amended by inserting before the period at the end of the first sentence "and increased by the exemption allowed under section 2052 or 2106(a)(4) (or the corresponding provisions of prior law) in determining the taxable estate of the transferor for purposes of the estate tax".

(B) Subparagraph (A) of section 2013(c)(1) is amended by striking "2010,".

(5) Paragraph (2) of section 2014(b) is amended by striking "2010,".

(6) Clause (ii) of section 2056A(b)(12)(C) is amended to read as follows:

"(ii) to treat any reduction in the tax imposed by paragraph (1)(A) by reason of the credit allowable under section 2010 (as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999) or the exemption allowable under section 2052 with respect to the decedent as a credit under section 2505 (as so in effect) or exemption under section 2521 (as the case may be) allowable to such surviving spouse for purposes of determining the amount of the exemption allowable under section 2521 with respect to taxable gifts made by the surviving spouse during the

year in which the spouse becomes a citizen or any subsequent year,".

(7) Paragraph (3) of section 2057(a) is amended to read as follows:

"(3) COORDINATION WITH EXEMPTION AMOUNT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), if this section applies to an estate, the exemption amount under section 2052 shall be $625,000.

"(B) INCREASE IN EXEMPTION AMOUNT IF DEDUCTION IS LESS THAN $675,000.—If the deduction allowed by this section is less than $675,000, the amount of the exemption amount under section 2052 shall be increased (but not above the amount which would apply to the estate without regard to this section) by the excess of $675,000 over the amount of the deduction allowed."

(8)(A) Subparagraph (B) of section 2101(b)(1) is amended by inserting before the comma "reduced by the aggregate amount of gifts for which credit was allowed by section 2505 (as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999)".

(B) Subsection (b) of section 2101 is amended by striking the last sentence.

(9) Section 2102 is amended by striking subsection (c).

(10) Subsection (a) of section 2106 is amended by adding at the end the following new paragraph:

"(4) EXEMPTION.—

"(A) IN GENERAL.—An exemption of $60,000.

"(B) RESIDENTS OF POSSESSIONS OF THE UNITED STATES.—In the case of a decedent who is considered to be a nonresident not a citizen of the United States under section 2209, the exemption under this paragraph shall be the greater of—

"(i) $60,000, or

"(ii) that proportion of $175,000 which the value of that part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.

"(C) SPECIAL RULES.—

"(i) COORDINATION WITH TREATIES.—To the extent required under any treaty obligation of the United States, the exemption allowed under this paragraph shall be equal to the amount which bears the same ratio to the exemption amount under section 2052 (for the calendar year in which the decedent died) as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated. For purposes of the preceding sentence, property shall not be treated as situated in the United States if such property is exempt from the tax imposed by this subchapter under any treaty obligation of the United States.

"(ii) COORDINATION WITH GIFT TAX EXEMPTION AND UNIFIED CREDIT.—If an exemption has been allowed

under section 2521 (or a credit has been allowed under section 2505 as in effect on the day before the date of the enactment of the Taxpayer Refund and Relief Act of 1999) with respect to any gift made by the decedent, each dollar amount contained in subparagraph (A) or (B) or the exemption amount applicable under clause (i) of this subparagraph (whichever applies) shall be reduced by the exemption so allowed under 2521 (or, in the case of such a credit, by the amount of the gift for which the credit was so allowed).''

(11)(A) Subsection (a) of section 2107 is amended by adding at the end the following new paragraph:

''(3) LIMITATION ON EXEMPTION AMOUNT.—Subparagraphs (B) and (C) of section 2106(a)(4) shall not apply in applying section 2106 for purposes of this section.''

(B) Subsection (c) of section 2107 is amended—

(i) by striking paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively, and

(ii) by striking the second sentence of paragraph (2) (as so redesignated).

(12) Section 2206 is amended by striking ''the taxable estate'' in the first sentence and inserting ''the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate''.

(13) Section 2207 is amended by striking ''the taxable estate'' in the first sentence and inserting ''the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate''.

(14) Subparagraph (B) of section 2207B(a)(1) is amended to read as follows:

''(B) the sum of the taxable estate and the amount of the exemption allowed under section 2052 or 2106(a)(4) in computing the taxable estate.''

(15) Subsection (a) of section 2503 is amended by striking ''section 2522'' and inserting ''section 2521''.

(16) Paragraph (1) of section 6018(a) is amended by striking ''the applicable exclusion amount in effect under section 2010(c)'' and inserting ''the exemption amount under section 2052''.

(17) Subparagraph (A) of section 6601(j)(2) is amended to read as follows:

''(A) the amount of the tax which would be imposed by chapter 11 on an amount of taxable estate equal to $1,000,000, or''.

(18) The table of sections for part II of subchapter A of chapter 11 is amended by striking the item relating to section 2010.

(19) The table of sections for part IV of subchapter A of chapter 11 is amended by inserting after the item relating to section 2051 the following new item:

''Sec. 2052. Exemption.''

(20) The table of sections for subchapter A of chapter 12 is amended by striking the item relating to section 2505.

(21) The table of sections for subchapter C of chapter 12 is amended by inserting before the item relating to section 2522 the following new item:

"Sec. 2521. Exemption."

(d) EFFECTIVE DATE.—The amendments made by this section—

(1) insofar as they relate to the tax imposed by chapter 11 of the Internal Revenue Code of 1986, shall apply to estates of decedents dying after December 31, 2000, and

(2) insofar as they relate to the tax imposed by chapter 12 of such Code, shall apply to gifts made after December 31, 2000.

Subtitle D—Modifications of Generation-Skipping Transfer Tax

SEC. 631. DEEMED ALLOCATION OF GST EXEMPTION TO LIFETIME TRANSFERS TO TRUSTS; RETROACTIVE ALLOCATIONS.

(a) IN GENERAL.—Section 2632 (relating to special rules for allocation of GST exemption) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) DEEMED ALLOCATION TO CERTAIN LIFETIME TRANSFERS TO GST TRUSTS.—

"(1) IN GENERAL.—If any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

"(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been—

"(A) allocated by such individual,

"(B) treated as allocated under subsection (b) with respect to a direct skip occurring during or before the calendar year in which the indirect skip is made, or

"(C) treated as allocated under paragraph (1) with respect to a prior indirect skip.

"(3) DEFINITIONS.—

"(A) INDIRECT SKIP.—For purposes of this subsection, the term 'indirect skip' means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

"(B) GST TRUST.—The term 'GST trust' means a trust that could have a generation-skipping transfer with respect to the transferor unless—

"(i) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons—

"(I) before the date that the individual attains age 46,

"(II) on or before 1 or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or

"(III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

"(ii) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

"(iii) the trust instrument provides that, if 1 or more individuals who are non-skip persons die on or before a date or event described in clause (i) or (ii), more than 25 percent of the trust corpus either must be distributed to the estate or estates of 1 or more of such individuals or is subject to a general power of appointment exercisable by 1 or more of such individuals;

"(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

"(v) the trust is a charitable lead annuity trust (within the meaning of section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of section 664(d)); or

"(vi) the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For purposes of this subparagraph, the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

"(4) AUTOMATIC ALLOCATIONS TO CERTAIN GST TRUSTS.—For purposes of this subsection, an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period. The fair market value of such transfer shall be the fair market value of the trust property at the close of the estate tax inclusion period.

"(5) APPLICABILITY AND EFFECT.—

"(A) IN GENERAL.—An individual—

"(i) may elect to have this subsection not apply to—

"(I) an indirect skip, or

"(II) any or all transfers made by such individual to a particular trust, and

"(ii) may elect to treat any trust as a GST trust for purposes of this subsection with respect to any or all transfers made by such individual to such trust.

"(B) ELECTIONS.—

"(i) ELECTIONS WITH RESPECT TO INDIRECT SKIPS.—An election under subparagraph (A)(i)(I) shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made or deemed to have been made pursuant to paragraph (4) or on such later date or dates as may be prescribed by the Secretary.

"(ii) OTHER ELECTIONS.—An election under clause (i)(II) or (ii) of subparagraph (A) may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

"(d) RETROACTIVE ALLOCATIONS.—

"(1) IN GENERAL.—If—

"(A) a non-skip person has an interest or a future interest in a trust to which any transfer has been made,

"(B) such person—

"(i) is a lineal descendant of a grandparent of the transferor or of a grandparent of the transferor's spouse or former spouse, and

"(ii) is assigned to a generation below the generation assignment of the transferor, and

"(C) such person predeceases the transferor,

then the transferor may make an allocation of any of such transferor's unused GST exemption to any previous transfer or transfers to the trust on a chronological basis.

"(2) SPECIAL RULES.—If the allocation under paragraph (1) by the transferor is made on a gift tax return filed on or before the date prescribed by section 6075(b) for gifts made within the calendar year within which the non-skip person's death occurred—

"(A) the value of such transfer or transfers for purposes of section 2642(a) shall be determined as if such allocation had been made on a timely filed gift tax return for each calendar year within which each transfer was made,

"(B) such allocation shall be effective immediately before such death, and

"(C) the amount of the transferor's unused GST exemption available to be allocated shall be determined immediately before such death.

"(3) FUTURE INTEREST.—For purposes of this subsection, a person has a future interest in a trust if the trust may permit income or corpus to be paid to such person on a date or dates in the future.".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 2632(b) is amended by striking "with respect to a direct skip" and inserting "or subsection (c)(1)".

(c) EFFECTIVE DATES.—

(1) DEEMED ALLOCATION.—Section 2632(c) of the Internal Revenue Code of 1986 (as added by subsection (a)), and the amendment made by subsection (b), shall apply to transfers subject to chapter 11 or 12 made after December 31, 1999, and to estate tax inclusion periods ending after December 31, 1999.

(2) RETROACTIVE ALLOCATIONS.—Section 2632(d) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to deaths of non-skip persons occurring after the date of the enactment of this Act.

SEC. 632. SEVERING OF TRUSTS.

(a) IN GENERAL.—Subsection (a) of section 2642 (relating to inclusion ratio) is amended by adding at the end the following new paragraph:

"(3) SEVERING OF TRUSTS.—

"(A) IN GENERAL.—If a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of this chapter.

"(B) QUALIFIED SEVERANCE.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified severance' means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of 2 or more trusts if—

"(I) the single trust was divided on a fractional basis, and

"(II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

"(ii) TRUSTS WITH INCLUSION RATIO GREATER THAN ZERO.—If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into 2 trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

"(iii) REGULATIONS.—The term 'qualified severance' includes any other severance permitted under regulations prescribed by the Secretary.

"(C) TIMING AND MANNER OF SEVERANCES.—A severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Secretary.".

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

SEC. 633. MODIFICATION OF CERTAIN VALUATION RULES.

(a) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—Paragraph (1) of section 2642(b) (relating to valuation rules, etc.) is amended to read as follows:

"(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by section 6075(b) for such transfer or is deemed to be made under section 2632 (b)(1) or (c)(1)—

"(A) the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of section 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and

"(B) such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, on and after the close of such estate tax inclusion period.".

(b) TRANSFERS AT DEATH.—Subparagraph (A) of section 2642(b)(2) is amended to read as follows:

"(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect as if included in the amendments made by section 1431 of the Tax Reform Act of 1986.

SEC. 634. RELIEF PROVISIONS.

(a) IN GENERAL.—Section 2642 is amended by adding at the end the following new subsection:

"(g) RELIEF PROVISIONS.—

"(1) RELIEF FOR LATE ELECTIONS.—

"(A) IN GENERAL.—The Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make—

"(i) an allocation of GST exemption described in paragraph (1) or (2) of subsection (b), and

"(ii) an election under subsection (b)(3) or (c)(5) of section 2632.

Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of this paragraph.

"(B) BASIS FOR DETERMINATIONS.—In determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

"(2) SUBSTANTIAL COMPLIANCE.—An allocation of GST exemption under section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.".

(b) EFFECTIVE DATES.—

(1) RELIEF FOR LATE ELECTIONS.—Section 2642(g)(1) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to requests pending on, or filed after, the date of the enactment of this Act.

(2) SUBSTANTIAL COMPLIANCE.—Section 2642(g)(2) of such Code (as so added) shall take effect on the date of the enactment of this Act and shall apply to allocations made prior to such date for purposes of determining the tax consequences of generation-skipping transfers with respect to which the period of time for filing claims for refund has not expired. No implication is intended with respect to the availability of relief for late elections or the application of a rule of substantial compliance prior to the enactment of this amendment.

Subtitle E—Conservation Easements

SEC. 641. EXPANSION OF ESTATE TAX RULE FOR CONSERVATION EASEMENTS.

(a) WHERE LAND IS LOCATED.—

(1) IN GENERAL.—Clause (i) of section 2031(c)(8)(A) (defining land subject to a conservation easement) is amended—

(A) by striking "25 miles" both places it appears and inserting "50 miles", and

(B) striking "10 miles" and inserting "25 miles".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to estates of decedents dying after December 31, 1999.

(b) CLARIFICATION OF DATE FOR DETERMINING VALUE OF LAND AND EASEMENT.—

(1) IN GENERAL.—Section 2031(c)(2) (defining applicable percentage) is amended by adding at the end the following new sentence: "The values taken into account under the preceding sentence shall be such values as of the date of the contribution referred to in paragraph (8)(B).".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to estates of decedents dying after December 31, 1997.

TITLE VII—TAX RELIEF FOR DISTRESSED COMMUNITIES AND INDUSTRIES

Subtitle A—American Community Renewal Act of 1999

SEC. 701. SHORT TITLE.

This subtitle may be cited as the "American Community Renewal Act of 1999".

SEC. 702. 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) all shall be chosen from nominated areas which are empowerment zones or enterprise communities (and are otherwise eligible for designation under this section); and

"(ii) 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) AL.—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, 2007,

"(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, 2000, and before January 1, 2008, 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 capital or profits interest in a domestic partnership if—

"(A) such interest is acquired by the taxpayer after December 31, 2000, and before January 1, 2008;

"(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, 2000, and before January 1, 2008;

"(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, 2008; 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. 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.

"(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 IRAS.—No deduction shall be allowed under this section for any taxable year to any person by

reason of a payment to an account for the benefit of a qualified individual if any amount is paid for such taxable year 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 section 72(t)(8)).

"(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 trade or business other than any trade or business—

"(i) which consists of the operation of any facility described in section 144(c)(6)(B), or

"(ii) which contravenes 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.

"(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 10 percent of the portion of such amount which is includible in gross income.

"(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) APPLICATION OF SECTION.—This section shall apply to amounts paid to a family development account for any taxable year beginning after December 31, 2000, and before January 1, 2008.

"SEC. 1400I. 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, 2007.

"PART IV—ADDITIONAL INCENTIVES

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

"SEC. 1400K. COMMERCIAL REVITALIZATION DEDUCTION.

"(a) GENERAL RULE.—At the election of the taxpayer, either—

"(1) one-half of any qualified revitalization expenditures chargeable to capital account with respect to any qualified revitalization building shall be allowable as a deduction for the taxable year in which the building is placed in service, or

"(2) a deduction for all such expenditures shall be allowable ratably over the 120-month period beginning with the month in which the building is placed in service.

The deduction provided by this section with respect to such expenditure shall be in lieu of any depreciation deduction otherwise allowable on account of such expenditure.

"(b) 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, 2000;

"(B) a commercial revitalization deduction amount is allocated to the building under subsection (d); and

"(C) depreciation (or amortization in lieu of depreciation) is allowable with respect to the building (without regard to this section).

"(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 (without regard to this section) and which is—

"(I) nonresidential real property; or

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

"(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; and

"(iii) for land (including land which is functionally related to such property and subordinate thereto).

"(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 deduction under this section for all preceding taxable years.

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

"(i) 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.

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

"(c) WHEN EXPENDITURES TAKEN INTO ACCOUNT.—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.

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

"(1) IN GENERAL.—The amount of the deduction determined under this section for any taxable year with respect to any building shall not exceed the commercial revitalization deduction amount (in the case of an amount determined under subsection (a)(2), the present value of such amount as determined under the rules of section 42(b)(2)(C) by substituting '100 percent' for '72 percent' in clause (ii) thereof) allocated to such building under this subsection by the commercial revitalization 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 DEDUCTION AMOUNT FOR AGENCIES.—

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

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

"(i) for each calendar year after 2000 and before 2008 is $6,000,000 for each renewal community in the State; and

"(ii) zero for each calendar year thereafter.

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

"(e) RESPONSIBILITIES OF COMMERCIAL REVITALIZATION AGENCIES.—

"(1) PLANS FOR ALLOCATION.—Notwithstanding any other provision of this section, the commercial revitalization deduction 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 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 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 non-profit 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.

"(f) REGULATIONS.—For purposes of this section, the Secretary shall, by regulations, provide for the application of rules similar to the rules of section 49 and subsections (a) and (b) of section 50.

"(g) TERMINATION.—This section shall not apply to any building placed in service after December 31, 2007.

"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, 2000, and before January 1, 2008; 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. 703. 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) with respect to expenditures paid or incurred after December 31, 2000.".

(b) EXTENSION OF TERMINATION DATE FOR RENEWAL COMMUNITIES.—Subsection (h) of section 198 is amended by inserting before the period "(December 31, 2007, in the case of a renewal community, as defined in section 1400E).".

SEC. 704. 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".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to individuals who begin work for the employer after December 31, 2000.

SEC. 705. 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 (19) the following new paragraph:

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

(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 family development accounts, the term 'excess contributions' means the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year to the accounts (other than a qualified rollover, as defined in section 1400H(c)(7)), 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 accounts 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 accounts 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.

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 DEDUCTION.—

(1) Section 172 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) NO CARRYBACK OF SECTION 1400K DEDUCTION BEFORE DATE OF THE ENACTMENT.—No portion of the net operating loss for any taxable year which is attributable to any commercial revitalization deduction determined under section 1400K may be carried back to a taxable year ending before the date of the enactment of section 1400K.".

(2) 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.

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

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

(B) by inserting "AND COMMERCIAL REVITALIZATION DEDUCTION" after "CREDIT" in the heading.

(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.".

Subtitle B—Farming Incentive

SEC. 711. PRODUCTION FLEXIBILITY CONTRACT PAYMENTS.

Any option to accelerate the receipt of any payment under a production flexibility contract which is payable under the Federal Agriculture Improvement and Reform Act of 1996 (7 U.S.C. 7200 et seq.), as in effect on the date of the enactment of this Act, shall be disregarded etermining the taxable year for which such payment is properly includible in gross income for purposes of the Internal Revenue Code of 1986.

Subtitle C—Oil and Gas Incentives

SEC. 721. 5-YEAR NET OPERATING LOSS CARRYBACK FOR LOSSES ATTRIBUTABLE TO OPERATING MINERAL INTERESTS OF INDEPENDENT OIL AND GAS PRODUCERS.

(a) IN GENERAL.—Paragraph (1) of section 172(b) (relating to years to which loss may be carried) is amended by adding at the end the following new subparagraph:

"(H) LOSSES ON OPERATING MINERAL INTERESTS OF INDEPENDENT OIL AND GAS PRODUCERS.—In the case of a taxpayer—

"(i) which has an eligible oil and gas loss (as defined in subsection (j)) for a taxable year, and

"(ii) which is not an integrated oil company (as defined in section 291(b)(4)),

such eligible oil and gas loss shall be a net operating loss carryback to each of the 5 taxable years preceding the taxable year of such loss.".

(b) ELIGIBLE OIL AND GAS LOSS.—Section 172 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) ELIGIBLE OIL AND GAS LOSS.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible oil and gas 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 operating mineral interests (as defined in section 614(d)) in oil and gas wells 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), an eligible oil and gas 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)(H) from any loss year may elect to have the carryback period with respect to such loss year determined without regard to subsection (b)(1)(H).".

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

SEC. 722. DEDUCTION FOR DELAY RENTAL PAYMENTS.

(a) IN GENERAL.—Section 263 (relating to capital expenditures) is amended by adding after subsection (i) the following new subsection:

"(j) DELAY RENTAL PAYMENTS FOR DOMESTIC OIL AND GAS WELLS.—

"(1) IN GENERAL.—Notwithstanding subsection (a), a taxpayer may elect to treat delay rental payments incurred in connection with the development of oil or gas within the United States (as defined in section 638) as payments which are not chargeable to capital account. Any payments so treated shall be

allowed as a deduction in the taxable year in which paid or incurred.

"(2) DELAY RENTAL PAYMENTS.—For purposes of paragraph (1), the term 'delay rental payment' means an amount paid for the privilege of deferring development of an oil or gas well.".

(b) CONFORMING AMENDMENT.—Section 263A(c)(3) is amended by inserting "263(j)," after "263(i),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred in taxable years beginning after December 31, 1999.

SEC. 723. ELECTION TO EXPENSE GEOLOGICAL AND GEOPHYSICAL EXPENDITURES.

(a) IN GENERAL.—Section 263 (relating to capital expenditures) is amended by adding after subsection (j) the following new subsection:

"(k) GEOLOGICAL AND GEOPHYSICAL EXPENDITURES FOR DOMESTIC OIL AND GAS WELLS.—Notwithstanding subsection (a), a taxpayer may elect to treat geological and geophysical expenses incurred in connection with the exploration for, or development of, oil or gas within the United States (as defined in section 638) as expenses which are not chargeable to capital account. Any expenses so treated shall be allowed as a deduction in the taxable year in which paid or incurred.".

(b) CONFORMING AMENDMENT.—Section 263A(c)(3) is amended by inserting "263(k)," after "263(j),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to costs paid or incurred in taxable years beginning after December 31, 1999.

SEC. 724. TEMPORARY SUSPENSION OF LIMITATION BASED ON 65 PERCENT OF TAXABLE INCOME.

(a) IN GENERAL.—Subsection (d) of section 613A (relating to limitation on percentage depletion in case of oil and gas wells) is amended by adding at the end the following new paragraph:

"(6) TEMPORARY SUSPENSION OF TAXABLE INCOME LIMIT.—Paragraph (1) shall not apply to taxable years beginning after December 31, 1998, and before January 1, 2005, including with respect to amounts carried under the second sentence of paragraph (1) to such taxable years.".

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

SEC. 725. DETERMINATION OF SMALL REFINER EXCEPTION TO OIL DEPLETION DEDUCTION.

(a) IN GENERAL.—Paragraph (4) of section 613A(d) (relating to certain refiners excluded) is amended to read as follows:

"(4) CERTAIN REFINERS EXCLUDED.—If the taxpayer or a related person engages in the refining of crude oil, subsection (c) shall not apply to the taxpayer for a taxable year if the average daily refinery runs of the taxpayer and the related person for the taxable year exceed 50,000 barrels. For purposes of this paragraph, the average daily refinery runs for any taxable year shall be determined by dividing the aggregate refinery runs for the taxable year by the number of days in the taxable year.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

Subtitle D—Timber Incentives

SEC. 731. TEMPORARY SUSPENSION OF MAXIMUM AMOUNT OF AMORTIZABLE REFORESTATION EXPENDITURES.

(a) INCREASE IN DOLLAR LIMITATION.—Paragraph (1) of section 194(b) (relating to amortization of reforestation expenditures) is amended by striking "$10,000 ($5,000" and inserting "$25,000 ($12,500".

(b) TEMPORARY SUSPENSION OF INCREASED DOLLAR LIMITATION.—Subsection (b) of section 194(b) (relating to amortization of reforestation expenditures) is amended by adding at the end the following new paragraph:

"(5) SUSPENSION OF DOLLAR LIMITATION.—Paragraph (1) shall not apply to taxable years beginning after December 31, 1999, and before January 1, 2004.

(c) CONFORMING AMENDMENT.—Paragraph (1) of section 48(b) is amended by striking "section 194(b)(1)" and inserting "section 194(b)(1) and without regard to section 194(b)(5)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 732. CAPITAL GAIN TREATMENT UNDER SECTION 631(b) TO APPLY TO OUTRIGHT SALES BY LAND OWNER.

(a) IN GENERAL.—Subsection (b) of section 631 (relating to disposal of timber with a retained economic interest) is amended—

(1) by inserting "AND OUTRIGHT SALES OF TIMBER" after ECONOMIC INTEREST" in the subsection heading, and

(2) by adding before the last sentence the following new sentence: "The requirement in the first sentence of this subsection to retain an economic interest in timber shall not apply to an outright sale of such timber by the owner thereof if such owner owned the land (at the time of such sale) from which the timber is cut.".

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

TITLE VIII—RELIEF FOR SMALL BUSINESSES

SEC. 801. DEDUCTION FOR 100 PERCENT OF HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—Paragraph (1) of section 162(l) 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 and the taxpayer's spouse and dependents.".

(b) CLARIFICATION OF LIMITATIONS ON OTHER COVERAGE.—The first sentence of section 162(l)(2)(B) is amended to read as follows: "Paragraph (1) shall not apply to any taxpayer for any calendar month for which the taxpayer participates in any subsidized health plan maintained by any employer (other than an employer described in section 401(c)(4)) of the taxpayer or the spouse of the taxpayer.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 802. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.

(a) IN GENERAL.—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 $30,000.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 803. REPEAL OF FEDERAL UNEMPLOYMENT SURTAX.

(a) IN GENERAL.—Section 3301 (relating to rate of Federal unemployment tax) is amended—

(1) by striking "2007" and inserting "2004", and

(2) by striking "2008" and inserting "2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to calendar years beginning after the date of the enactment of this Act.

SEC. 804. INCREASED DEDUCTION FOR MEAL EXPENSES; INCREASED DEDUCTIBILITY OF BUSINESS MEAL EXPENSES FOR INDIVIDUALS SUBJECT TO FEDERAL LIMITATIONS ON HOURS OF SERVICE.

(a) IN GENERAL.—Paragraph (1) of section 274(n) (relating to only 50 percent of meal and entertainment expenses allowed as deduction) is amended by striking "50 percent" in the text and inserting "the allowable percentage".

(b) ALLOWABLE PERCENTAGES.—Subsection (n) of section 274 is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (2) the following new paragraph:

"(2) ALLOWABLE PERCENTAGE.—For purposes of paragraph (1), the allowable percentage is—

"(A) in the case of amounts for items described in paragraph (1)(B), 50 percent, and

"(B) in the case of expenses for food or beverages, the percentage determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2000 through 2005	*50*
2006	*55*
2007 and thereafter	*60.".*

(c) INDIVIDUALS SUBJECT TO FEDERAL LIMITATIONS ON HOURS OF SERVICE.—The table in section 274(n)(4)(B) (relating to special rule for individuals subject to Federal hours of service), as redesignated by subsection (b), is amended—

(1) by striking "or 2007", and

(2) by striking "2008" and inserting "2007".

(d) CONFORMING AMENDMENTS.—

(1) The heading for subsection (n) of section 274 is amended by striking "50 PERCENT" and inserting "LIMITED PERCENTAGES".

(2) Subparagraph (A) of section 274(n)(4), as redesignated by subsection (b), is amended by striking "50 percent" and inserting "the allowable percentage".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 805. INCOME AVERAGING FOR FARMERS AND FISHERMEN NOT TO INCREASE ALTERNATIVE MINIMUM TAX LIABILITY.

(a) IN GENERAL.—Section 55(c) (defining regular tax) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following:

"(2) COORDINATION WITH INCOME AVERAGING FOR FARMERS AND FISHERMEN.—Solely for purposes of this section, section 1301 (relating to averaging of farm and fishing income) shall not apply in computing the regular tax.".

(b) ALLOWING INCOME AVERAGING FOR FISHERMEN.—

(1) IN GENERAL.—Section 1301(a) is amended by striking "farming business" and inserting "farming business or fishing business,".

(2) DEFINITION OF ELECTED FARM INCOME.—

(A) IN GENERAL.—Clause (i) of section 1301(b)(1)(A) is amended by inserting "or fishing business" before the semicolon.

(B) CONFORMING AMENDMENT.—Subparagraph (B) of section 1301(b)(1) is amended by inserting "or fishing business" after "farming business" both places it occurs.

(3) DEFINITION OF FISHING BUSINESS.—Section 1301(b) is amended by adding at the end the following new paragraph:

"(4) FISHING BUSINESS.—The term 'fishing business' means the conduct of commercial fishing as defined in section 3 of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 806. FARM, FISHING, AND RANCH RISK MANAGEMENT ACCOUNTS.

(a) IN GENERAL.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deductions taken) is amended by inserting after section 468B the following:

"SEC. 468C. FARM AND RANCH RISK MANAGEMENT ACCOUNTS.

"(a) DEDUCTION ALLOWED.—In the case of an individual engaged in an eligible farming business or commercial fishing, there shall be allowed as a deduction for any taxable year the amount paid in cash by the taxpayer during the taxable year to a Farm, Fishing, and Ranch Risk Management Account (hereinafter referred to as the 'FFARRM Account').

"(b) LIMITATION.—

"(1) CONTRIBUTIONS.—The amount which a taxpayer may pay into the FFARRM Account for any taxable year shall not exceed 20 percent of so much of the taxable income of the tax-

payer (determined without regard to this section) which is attributable (determined in the manner applicable under section 1301) to any eligible farming business or commercial fishing.

"(2) DISTRIBUTIONS.—Distributions from a FFARRM Account may not be used to purchase, lease, or finance any new fishing vessel, add capacity to any fishery, or otherwise contribute to the overcapitalization of any fishery. The Secretary of Commerce shall implement regulations to enforce this paragraph.

"(c) ELIGIBLE BUSINESSES.—For purposes of this section—

"(1) ELIGIBLE FARMING BUSINESS.—The term 'eligible farming business' means any farming business (as defined in section 263A(e)(4)) which is not a passive activity (within the meaning of section 469(c)) of the taxpayer.

"(2) COMMERCIAL FISHING.—The term 'commercial fishing' has the meaning given such term by section (3) of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802) but only if such fishing is not a passive activity (within the meaning of section 469(c)) of the taxpayer.

"(d) FFARRM ACCOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'FFARRM Account' means a trust created or organized in the United States for the exclusive benefit of the taxpayer, but only if the written governing instrument creating the trust meets the following requirements:

"(A) No contribution will be accepted for any taxable year in excess of the amount allowed as a deduction under subsection (a) for such year.

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

"(C) The assets of the trust consist entirely of cash or of obligations which have adequate stated interest (as defined in section 1274(c)(2)) and which pay such interest not less often than annually.

"(D) All income of the trust is distributed currently to the grantor.

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

"(2) ACCOUNT TAXED AS GRANTOR TRUST.—The grantor of a FFARRM Account shall be treated for purposes of this title as the owner of such Account and shall be subject to tax thereon in accordance with subpart E of part I of subchapter J of this chapter (relating to grantors and others treated as substantial owners).

"(e) INCLUSION OF AMOUNTS DISTRIBUTED.—

"(1) IN GENERAL.—Except as provided in paragraph (2), there shall be includible in the gross income of the taxpayer for any taxable year—

"(A) any amount distributed from a FFARRM Account of the taxpayer during such taxable year, and

"(B) any deemed distribution under—

"(i) subsection (f)(1) (relating to deposits not distributed within 5 years),

"(ii) subsection (f)(2) (relating to cessation in eligible farming business), and

"(iii) subparagraph (A) or (B) of subsection (f)(3) (relating to prohibited transactions and pledging account as security).

"(2) EXCEPTIONS.—Paragraph (1)(A) shall not apply to—

"(A) any distribution to the extent attributable to income of the Account, and

"(B) the distribution of any contribution paid during a taxable year to a FFARRM Account to the extent that such contribution exceeds the limitation applicable under subsection (b) if requirements similar to the requirements of section 408(d)(4) are met.

For purposes of subparagraph (A), distributions shall be treated as first attributable to income and then to other amounts.

"(f) SPECIAL RULES.—

"(1) TAX ON DEPOSITS IN ACCOUNT WHICH ARE NOT DISTRIBUTED WITHIN 5 YEARS.—

"(A) IN GENERAL.—If, at the close of any taxable year, there is a nonqualified balance in any FFARRM Account—

"(i) there shall be deemed distributed from such Account during such taxable year an amount equal to such balance, and

"(ii) the taxpayer's tax imposed by this chapter for such taxable year shall be increased by 10 percent of such deemed distribution.

The preceding sentence shall not apply if an amount equal to such nonqualified balance is distributed from such Account to the taxpayer before the due date (including extensions) for filing the return of tax imposed by this chapter for such year (or, if earlier, the date the taxpayer files such return for such year).

"(B) NONQUALIFIED BALANCE.—For purposes of subparagraph (A), the term 'nonqualified balance' means any balance in the Account on the last day of the taxable year which is attributable to amounts deposited in such Account before the 4th preceding taxable year.

"(C) ORDERING RULE.—For purposes of this paragraph, distributions from a FFARRM Account (other than distributions of current income) shall be treated as made from deposits in the order in which such deposits were made, beginning with the earliest deposits.

"(2) CESSATION IN ELIGIBLE BUSINESS.—At the close of the first disqualification period after a period for which the taxpayer was engaged in an eligible farming business or commercial fishing, there shall be deemed distributed from the FFARRM Account of the taxpayer an amount equal to the balance in such Account (if any) at the close of such disqualification period. For purposes of the preceding sentence, the term 'disqualification period' means any period of 2 consecutive taxable years for which the taxpayer is not engaged in an eligible farming business or commercial fishing.

"(3) CERTAIN RULES TO APPLY.—Rules similar to the following rules shall apply for purposes of this section:

"(A) Section 220(f)(8) (relating to treatment on death).

"(B) Section 408(e)(2) (relating to loss of exemption of account where individual engages in prohibited transaction).

"(C) Section 408(e)(4) (relating to effect of pledging account as security).

"(D) Section 408(g) (relating to community property laws).

"(E) Section 408(h) (relating to custodial accounts).

"(4) TIME WHEN PAYMENTS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a payment to a FFARRM Account on the last day of a taxable year if such payment is made on account of such taxable year and is made on or before the due date (without regard to extensions) for filing the return of tax for such taxable year.

"(5) INDIVIDUAL.—For purposes of this section, the term 'individual' shall not include an estate or trust.

"(6) DEDUCTION NOT ALLOWED FOR SELF-EMPLOYMENT TAX.—The deduction allowable by reason of subsection (a) shall not be taken into account in determining an individual's net earnings from self-employment (within the meaning of section 1402(a)) for purposes of chapter 2.

"(g) REPORTS.—The trustee of a FFARRM Account shall make such reports regarding such Account to the Secretary and to the person for whose benefit the Account is maintained with respect to contributions, distributions, and such other matters as the Secretary may require under regulations. The reports required by this subsection shall be filed at such time and in such manner and furnished to such persons at such time and in such manner as may be required by such regulations.".

(b) TAX ON EXCESS CONTRIBUTIONS.—

(1) Subsection (a) of section 4973 (relating to tax on excess contributions to certain tax-favored accounts and annuities) is amended by striking "or" at the end of paragraph (3), by redesignating paragraph (4) as paragraph (5), and by inserting after paragraph (3) the following:

"(4) a FFARRM Account (within the meaning of section 468C(d)), or".

(2) Section 4973 is amended by adding at the end the following:

"(g) EXCESS CONTRIBUTIONS TO FFARRM ACCOUNTS.—For purposes of this section, in the case of a FFARRM Account (within the meaning of section 468C(d)), the term 'excess contributions' means the amount by which the amount contributed for the taxable year to the Account exceeds the amount which may be contributed to the Account under section 468C(b) for such taxable year. For purposes of this subsection, any contribution which is distributed out of the FFARRM Account in a distribution to which section 468C(e)(2)(B) applies shall be treated as an amount not contributed.".

(3) The section heading for section 4973 is amended to read as follows:

"SEC. 4973. EXCESS CONTRIBUTIONS TO CERTAIN ACCOUNTS, ANNUITIES, ETC.".

(4) The table of sections for chapter 43 is amended by striking the item relating to section 4973 and inserting the following:

"Sec. 4973. Excess contributions to certain accounts, annuities, etc.".

(c) TAX ON PROHIBITED TRANSACTIONS.—

(1) Subsection (c) of section 4975 (relating to tax on prohibited transactions) is amended by adding at the end the following:

"(6) SPECIAL RULE FOR FFARRM ACCOUNTS.—A person for whose benefit a FFARRM Account (within the meaning of section 468C(d)) is established 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 FFARRM Account by reason of the application of section 468C(f)(3)(A) to such account.".

(2) Paragraph (1) of section 4975(e) is amended by redesignating subparagraphs (E) and (F) as subparagraphs (F) and (G), respectively, and by inserting after subparagraph (D) the following:

"(E) a FFARRM Account described in section 468C(d),".

(d) FAILURE TO PROVIDE REPORTS ON FFARRM ACCOUNTS.—Paragraph (2) of section 6693(a) (relating to failure to provide reports on certain tax-favored accounts or annuities) is amended by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E), respectively, and by inserting after subparagraph (B) the following:

"(C) section 468C(g) (relating to FFARRM Accounts),".

(e) CLERICAL AMENDMENT.—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by inserting after the item relating to section 468B the following:

"Sec. 468C. Farm, Fishing and Ranch Risk Management Accounts.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 807. EXCLUSION OF INVESTMENT SECURITIES INCOME FROM PASSIVE INCOME TEST FOR BANK S CORPORATIONS.

(a) IN GENERAL.—Section 1362(d)(3)(C) (defining passive investment income) is amended by adding at the end the following:

"(v) EXCEPTION FOR BANKS; ETC.—In the case of a bank (as defined in section 581), a bank holding company (as defined in section 246A(c)(3)(B)(ii)), or a qualified subchapter S subsidiary bank, the term 'passive investment income' shall not include—

"(I) interest income earned by such bank, bank holding company, or qualified subchapter S subsidiary bank, or

"(II) dividends on assets required to be held by such bank, bank holding company, or qualified subchapter S subsidiary bank to conduct a banking business, including stock in the Federal Re-

serve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 808. TREATMENT OF QUALIFYING DIRECTOR SHARES.

(a) IN GENERAL.—Section 1361 is amended by adding at the end the following:

"(f) TREATMENT OF QUALIFYING DIRECTOR SHARES.—

"(1) IN GENERAL.—For purposes of this subchapter—

"(A) qualifying director shares shall not be treated as a second class of stock, and

"(B) no person shall be treated as a shareholder of the corporation by reason of holding qualifying director shares.

"(2) QUALIFYING DIRECTOR SHARES DEFINED.—For purposes of this subsection, the term 'qualifying director shares' means any shares of stock in a bank (as defined in section 581) or in a bank holding company registered as such with the Federal Reserve System—

"(i) which are held by an individual solely by reason of status as a director of such bank or company or its controlled subsidiary; and

"(ii) which are subject to an agreement pursuant to which the holder is required to dispose of the shares of stock upon termination of the holder's status as a director at the same price as the individual acquired such shares of stock.

"(3) DISTRIBUTIONS.—A distribution (not in part or full payment in exchange for stock) made by the corporation with respect to qualifying director shares shall be includible as ordinary income of the holder and deductible to the corporation as an expense in computing taxable income under section 1363(b) in the year such distribution is received.".

(b) CONFORMING AMENDMENTS.—

(1) Section 1361(b)(1) is amended by inserting ", except as provided in subsection (f)," before "which does not".

(2) Section 1366(a) is amended by adding at the end the following:

"(3) ALLOCATION WITH RESPECT TO QUALIFYING DIRECTOR SHARES.—The holders of qualifying director shares (as defined in section 1361(f)) shall not, with respect to such shares of stock, be allocated any of the items described in paragraph (1).".

(3) Section 1373(a) is amended by striking "and" at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting ", and", and adding at the end the following:

"(3) no amount of an expense deductible under this subchapter by reason of section 1361(f)(3) shall be apportioned or allocated to such income.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

TITLE IX—INTERNATIONAL TAX RELIEF

SEC. 901. INTEREST ALLOCATION RULES.

(a) ELECTION TO ALLOCATE INTEREST ON A WORLDWIDE BASIS.—Subsection (e) of section 864 (relating to rules for allocating interest, etc.) is amended by redesignating paragraphs (6) and (7) as paragraphs (7) and (8), respectively, and by inserting after paragraph (5) the following new paragraph:

"(6) ELECTION TO ALLOCATE INTEREST ON A WORLDWIDE BASIS.—

"(A) IN GENERAL.—Except as provided in this paragraph, this subsection shall be applied by treating a worldwide affiliated group for which an election under this paragraph is in effect as an affiliated group solely for purposes of allocating and apportioning interest expense of each domestic corporation which is a member of such group.

"(B) WORLDWIDE AFFILIATED GROUP.—For purposes of this paragraph, the term 'worldwide affiliated group' means the group of corporations which consists of—

"(i) all corporations in an affiliated group (as defined in section 1504 without regard to paragraphs (2) and (4) of section 1504(b)), and

"(ii) all foreign corporations (other than a FSC, as defined in section 922(a)) with respect to which corporations described in clause (i) own stock meeting the ownership requirements of section 957(a).

For purposes of clause (ii), ownership shall be determined under section 958; except that paragraphs (3) and (4) of section 318(a) shall not apply for purposes of section 958(b).

"(C) TREATMENT OF WORLDWIDE AFFILIATED GROUP.—For purposes of applying paragraph (1), the taxable income of the domestic members of a worldwide affiliated group from sources outside the United States shall be determined by allocating and apportioning the interest expense of such domestic members to such income in an amount equal to the excess (if any) of—

"(i) the total interest expense of the worldwide affiliated group multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to all the assets of the worldwide affiliated group, over

"(ii) the interest expense of all foreign corporations which are members of the worldwide affiliated group to the extent such interest expense of such foreign corporations would have been allocated and apportioned to foreign source income if this subsection were applied to a group consisting of all the foreign corporations in such worldwide affiliated group.

"(D) ASSETS AND INTEREST EXPENSE OF FOREIGN CORPORATIONS.—

"(i) IN GENERAL.—For purposes of subparagraph (C), only the applicable percentage of the interest expense and assets of a foreign corporation described in subparagraph (B)(ii) shall be taken into account.

"(ii) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the term 'applicable percentage' means, with respect to any foreign corporation, the percentage equal to the ratio which the value of the stock in such corporation taken into account under subparagraph (B)(ii) (without regard to stock considered as owned under section 958(b)) bears to the aggregate value of all stock in such corporation.

"(E) ELECTION.—An election under this paragraph with respect to any worldwide affiliated group may be made only by the common parent of the affiliated group referred to in subparagraph (B)(i) and may be made only for the first taxable year beginning after December 31, 2001, in which a worldwide affiliated group exists which includes such affiliated group and at least 1 corporation described in subparagraph (B)(ii). Such an election, once made, shall apply to such common parent and all other corporations which are members of such worldwide affiliated group for such taxable year and all subsequent years unless revoked with the consent of the Secretary.".

(b) ELECTION TO ALLOCATE INTEREST WITHIN FINANCIAL INSTITUTION GROUPS AND SUBSIDIARY GROUPS.—Section 864 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) ELECTION TO APPLY SUBSECTION (e) ON BASIS OF FINANCIAL INSTITUTION GROUP AND SUBSIDIARY GROUPS.—

"(1) IN GENERAL.—In the case of a worldwide affiliated group for which an election under subsection (e)(6) is in effect, subsection (e) shall be applied—

"(A) by treating an electing financial institution group as if it were a separate worldwide affiliated group, and

"(B) by treating each electing subsidiary group as if it were a separate worldwide affiliated group for purposes of allocating interest expense with respect to qualified indebtedness of members of an electing subsidiary group.

Subsection (e) shall apply to any such electing group in the same manner as subsection (e) applies to the pre-election worldwide affiliated group of which such electing group is a part.

"(2) ELECTING FINANCIAL INSTITUTION GROUP.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'electing financial institution group' means any group of corporations if—

"(i) such group consists only of all of the financial corporations in the pre-election worldwide affiliated group, and

"(ii) an election under this paragraph is in effect for such group of corporations.

"(B) FINANCIAL CORPORATION.—

"(i) IN GENERAL.—The term 'financial corporation' means any corporation if at least 80 percent of its gross income is income described in section 904(d)(2)(C)(ii) and the regulations thereunder which is derived from transactions with unrelated persons.

"(ii) INCOME FROM RELATED FINANCIAL CORPORATIONS.—Dividend income, and income described in section 904(d)(2)(C)(ii) and the regulations thereunder, which is derived directly or indirectly from a financial corporation (as defined in clause (i) without regard to this clause) which is not an unrelated person shall be treated as income described in clause (i).

"(iii) BANK HOLDING COMPANIES.—To the extent provided in regulations prescribed by the Secretary, a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956) shall be treated as a corporation meeting the requirements of clause (i).

"(iv) ANTIABUSE RULE.—For purposes of this subparagraph, there shall be disregarded any item of income or gain from a transaction or series of transactions a principal purpose of which is the qualification of any corporation as a financial corporation.

"(C) EFFECT OF CERTAIN TRANSACTIONS.—Rules similar to the rules of paragraph (3)(D) shall apply to transactions between any member of the electing financial institution group and any member of the pre-election worldwide affiliated group (other than a member of the electing financial institution group).

"(D) ELECTION.—An election under this paragraph with respect to any financial institution group may be made only by the common parent of the pre-election worldwide affiliated group and may be made only for the first taxable year beginning after December 31, 2001, in which such affiliated group includes 1 or more financial corporations described in subparagraph (B). Such an election, once made, shall apply to such taxable year and all subsequent years unless revoked with the consent of the Secretary.

"(3) ELECTING SUBSIDIARY GROUPS.—

"(A) IN GENERAL.—The term 'electing subsidiary group' means any group of corporations if—

"(i) such group consists only of corporations in the pre-election worldwide affiliated group,

"(ii) such group includes—

"(I) a domestic corporation (which is not the common parent of the pre-election worldwide affiliated group or a member of an electing financial institution group) which incurs interest expense with respect to qualified indebtedness, and

"(II) every other corporation (other than a member of an electing financial institution group) which is in the pre-election worldwide affiliated group and which would be a member of an affiliated group having such domestic corporation as the common parent, and

"(iii) an election under this paragraph is in effect for such group.

"(B) EQUALIZATION RULE.—All interest expense of a domestic corporation which is a member of a pre-election

worldwide affiliated group (other than subsidiary group interest expense) shall be treated as allocated to foreign source income to the extent such expense does not exceed the excess (if any) of—

"(i) the interest expense of the pre-election worldwide affiliated group (including subsidiary group interest expense) which would (but for any election under this paragraph) be allocated to foreign source income, over

"(ii) the subsidiary group interest expense allocated to foreign source income.

For purposes of the preceding sentence, the subsidiary group interest expense is the interest expense to which subsection (e) applies separately by reason of paragraph (1)(B).

"(C) QUALIFIED INDEBTEDNESS.—For purposes of this subsection, the term 'qualified indebtedness' means any indebtedness of a domestic corporation—

"(i) which is held by an unrelated person, and

"(ii) which is not guaranteed (or otherwise supported) by any corporation which is a member of the pre-election worldwide affiliated group other than a corporation which is a member of the electing subsidiary group.

"(D) EFFECT OF CERTAIN TRANSACTIONS ON QUALIFIED INDEBTEDNESS.—In the case of a corporation which is a member of an electing subsidiary group, to the extent that such corporation—

"(i) distributes dividends or makes other distributions with respect to its stock after the date of the enactment of this paragraph to any member of the pre-election worldwide affiliated group (other than to a member of the electing subsidiary group) in excess of the greater of—

"(I) its average annual dividend (expressed as a percentage of current earnings and profits) during the 5-taxable-year period ending with the taxable year preceding the taxable year, or

"(II) 25 percent of its average annual earnings and profits for such 5 taxable year period, or

"(ii) deals with any person in any manner not clearly reflecting the income of the corporation (as determined under principles similar to the principles of section 482),

except as provided by the Secretary, an amount of qualified indebtedness equal to the excess distribution or the understatement or overstatement of income, as the case may be, shall be recharacterized (for the taxable year and subsequent taxable years) for purposes of this subsection as indebtedness which is not qualified indebtedness. If a corporation has not been in existence for 5 taxable years, this subparagraph shall be applied with respect to the period it was in existence.

"(E) ELECTION.—An election under this paragraph with respect to any electing subsidiary group may be made

only by the common parent of the pre-election worldwide affiliated group. Such an election, once made, shall apply to the taxable year for which made and the 4 succeeding taxable years unless revoked with the consent of the Secretary. No election may be made under this paragraph if the effect of the election would be to have the same member of the pre-election worldwide affiliated group included in more than 1 electing subsidiary group.

"(4) PRE-ELECTION WORLDWIDE AFFILIATED GROUP.—For purposes of this subsection, the term 'pre-election worldwide affiliated group' means, with respect to a corporation, the worldwide affiliated group of which such corporation would (but for an election under this subsection) be a member for purposes of applying subsection (e).

"(5) UNRELATED PERSON.—For purposes of this subsection, the term 'unrelated person' means any person not bearing a relationship specified in section 267(b) or 707(b)(1) to the corporation.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out this subsection and subsection (e), including regulations—

"(A) providing for the direct allocation of interest expense in other circumstances where such allocation would be appropriate to carry out the purposes of this subsection,

"(B) preventing assets or interest expense from being taken into account more than once, and

"(C) dealing with changes in members of any group (through acquisitions or otherwise) treated under this subsection as an affiliated group for purposes of subsection (e).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 902. LOOK-THRU RULES TO APPLY TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.

(a) IN GENERAL.—Section 904(d)(4) (relating to application of look-thru rules to dividends from noncontrolled section 902 corporations) is amended to read as follows:

"(4) LOOK-THRU APPLIES TO DIVIDENDS FROM NONCONTROLLED SECTION 902 CORPORATIONS.—

"(A) IN GENERAL.—For purposes of this subsection, any dividend from a noncontrolled section 902 corporation with respect to the taxpayer shall be treated as income in a separate category in proportion to the ratio of—

"(i) the portion of earnings and profits attributable to income in such category, to

"(ii) the total amount of earnings and profits.

"(B) SPECIAL RULES.—For purposes of this paragraph—

"(i) IN GENERAL.—Rules similar to the rules of paragraph (3)(F) shall apply; except that the term 'separate category' shall include the category of income described in paragraph (1)(I).

"(ii) EARNINGS AND PROFITS.—

"(I) IN GENERAL.—The rules of section 316 shall apply.

"(II) REGULATIONS.—The Secretary may prescribe regulations regarding the treatment of distributions out of earnings and profits for periods before the taxpayer's acquisition of the stock to which the distributions relate.

"(iii) DIVIDENDS NOT ALLOCABLE TO SEPARATE CATEGORY.—The portion of any dividend from a noncontrolled section 902 corporation which is not treated as income in a separate category under subparagraph (A) shall be treated as a dividend to which subparagraph (A) does not apply.

"(iv) LOOK-THRU WITH RESPECT TO CARRYFORWARDS OF CREDIT.—Rules similar to subparagraph (A) also shall apply to any carryforward under subsection (c) from a taxable year beginning before January 1, 2002, of tax allocable to a dividend from a noncontrolled section 902 corporation with respect to the taxpayer.".

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (E) of section 904(d)(1), as in effect both before and after the amendments made by section 1105 of the Taxpayer Relief Act of 1997, is hereby repealed.

(2) Section 904(d)(2)(C)(iii), as so in effect, is amended by striking subclause (II) and by redesignating subclause (III) as subclause (II).

(3) The last sentence of section 904(d)(2)(D), as so in effect, is amended to read as follows: "Such term does not include any financial services income.".

(4) Section 904(d)(2)(E) is amended by striking clauses (ii) and (iv) and by redesignating clause (iii) as clause (ii).

(5) Section 904(d)(3)(F) is amended by striking "(D), or (E)" and inserting "or (D)".

(6) Section 864(d)(5)(A)(i) is amended by striking "(C)(iii)(III)" and inserting "(C)(iii)(II)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 903. CLARIFICATION OF TREATMENT OF PIPELINE TRANSPORTATION INCOME.

(a) IN GENERAL.—Section 954(g)(1) (defining foreign base company oil related income) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the pipeline transportation of oil or gas within such foreign country.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of controlled foreign corporations beginning after December 31, 2001, and taxable years of United States shareholders with or within which such taxable years of controlled foreign corporations end.

SEC. 904. SUBPART F TREATMENT OF INCOME FROM TRANSMISSION OF HIGH VOLTAGE ELECTRICITY.

(a) IN GENERAL.—Paragraph (2) of section 954(e) (relating to foreign base company services income) is amended by striking "or" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", or", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the transmission of high voltage electricity.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years of controlled foreign corporations beginning after December 31, 2001, and taxable years of United States shareholders with or within which such taxable years of controlled foreign corporations end.

SEC. 905. RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.

(a) GENERAL RULE.—Section 904 is amended by redesignating subsections (g), (h), (i), (j), and (k) as subsections (h), (i), (j), (k), and (l), respectively, and by inserting after subsection (f) the following new subsection:

"(g) RECHARACTERIZATION OF OVERALL DOMESTIC LOSS.—

"(1) GENERAL RULE.—For purposes of this subpart and section 936, in the case of any taxpayer who sustains an overall domestic loss for any taxable year beginning after December 31, 2005, that portion of the taxpayer's taxable income from sources within the United States for each succeeding taxable year which is equal to the lesser of—

"(A) the amount of such loss (to the extent not used under this paragraph in prior taxable years), or

"(B) 50 percent of the taxpayer's taxable income from sources within the United States for such succeeding taxable year,

shall be treated as income from sources without the United States (and not as income from sources within the United States).

"(2) OVERALL DOMESTIC LOSS DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'overall domestic loss' means any domestic loss to the extent such loss offsets taxable income from sources without the United States for the taxable year or for any preceding taxable year by reason of a carryback. For purposes of the preceding sentence, the term 'domestic loss' means the amount by which the gross income for the taxable year from sources within the United States is exceeded by the sum of the deductions properly apportioned or allocated thereto (determined without regard to any carryback from a subsequent taxable year).

"(B) TAXPAYER MUST HAVE ELECTED FOREIGN TAX CREDIT FOR YEAR OF LOSS.—The term 'overall domestic loss' shall not include any loss for any taxable year unless the taxpayer chose the benefits of this subpart for such taxable year.

"(3) CHARACTERIZATION OF SUBSEQUENT INCOME.—

"(A) IN GENERAL.—Any income from sources within the United States that is treated as income from sources without the United States under paragraph (1) shall be allo-

cated among and increase the income categories in proportion to the loss from sources within the United States previously allocated to those income categories.

"(B) INCOME CATEGORY.—For purposes of this paragraph, the term 'income category' has the meaning given such term by subsection (f)(5)(E)(i).

"(4) COORDINATION WITH SUBSECTION (f).—The Secretary shall prescribe such regulations as may be necessary to coordinate the provisions of this subsection with the provisions of subsection (f).".

(b) CONFORMING AMENDMENTS.—

(1) Section 535(d)(2) is amended by striking "section 904(g)(6)" and inserting "section 904(h)(6)".

(2) Subparagraph (A) of section 936(a)(2) is amended by striking "section 904(f)" and inserting "subsections (f) and (g) of section 904".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to losses for taxable years beginning after December 31, 2005.

SEC. 906. TREATMENT OF MILITARY PROPERTY OF FOREIGN SALES CORPORATIONS.

(a) IN GENERAL.—Section 923(a) (defining exempt foreign trade income) is amended by striking paragraph (5) and by redesignating paragraph (6) as paragraph (5).

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 907. TREATMENT OF CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.

(a) TREATMENT OF CERTAIN DIVIDENDS.—

(1) NONRESIDENT ALIEN INDIVIDUALS.—Section 871 (relating to tax on nonresident alien individuals) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) EXEMPTION FOR CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

"(1) INTEREST-RELATED DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any interest-related dividend received from a regulated investment company.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply—

"(i) to any interest-related dividend received from a regulated investment company by a person to the extent such dividend is attributable to interest (other than interest described in clause (i), (iii), or the last sentence of subparagraph (E)) received by such company on indebtedness issued by such person or by any corporation or partnership with respect to which such person is a 10-percent shareholder,

"(ii) to any interest-related dividend with respect to stock of a regulated investment company unless the person who would otherwise be required to deduct and withhold tax from such dividend under chapter 3 receives a statement (which meets requirements similar

to the requirements of subsection (h)(5)) that the beneficial owner of such stock is not a United States person, and

"(iii) to any interest-related dividend paid to any person within a foreign country (or any interest-related dividend payment addressed to, or for the account of, persons within such foreign country) during any period described in subsection (h)(6) with respect to such country.

Clause (iii) shall not apply to any dividend with respect to any stock the holding period of which begins on or before the date of the publication of the Secretary's determination under subsection (h)(6).

"(C) INTEREST-RELATED DIVIDEND.—For purposes of this paragraph, an interest-related dividend is any dividend (or part thereof) which is designated by the regulated investment company as an interest-related dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified net interest income of the company for such taxable year, the portion of each distribution which shall be an interest-related dividend shall be only that portion of the amounts so designated which such qualified net interest income bears to the aggregate amount so designated.

"(D) QUALIFIED NET INTEREST INCOME.—For purposes of subparagraph (C), the term 'qualified net interest income' means the qualified interest income of the regulated investment company reduced by the deductions properly allocable to such income.

"(E) QUALIFIED INTEREST INCOME.—For purposes of subparagraph (D), the term 'qualified interest income' means the sum of the following amounts derived by the regulated investment company from sources within the United States:

"(i) Any amount includible in gross income as original issue discount (within the meaning of section 1273) on an obligation payable 183 days or less from the date of original issue (without regard to the period held by the company).

"(ii) Any interest includible in gross income (including amounts recognized as ordinary income in respect of original issue discount or market discount or acquisition discount under part V of subchapter P and such other amounts as regulations may provide) on an obligation which is in registered form; except that this clause shall not apply to—

"(I) any interest on an obligation issued by a corporation or partnership if the regulated investment company is a 10-percent shareholder in such corporation or partnership, and

"(II) any interest which is treated as not being portfolio interest under the rules of subsection (h)(4).

"(iii) Any interest referred to in subsection (i)(2)(A) (without regard to the trade or business of the regulated investment company).

"(iv) Any interest-related dividend includable in gross income with respect to stock of another regulated investment company.

Such term includes any interest derived by the regulated investment company from sources outside the United States other than interest that is subject to a tax imposed by a foreign jurisdiction if the amount of such tax is reduced (or eliminated) by a treaty with the United States.

"(F) 10-PERCENT SHAREHOLDER.—For purposes of this paragraph, the term '10-percent shareholder' has the meaning given such term by subsection (h)(3)(B).

"(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1)(A) of subsection (a) on any short-term capital gain dividend received from a regulated investment company.

"(B) EXCEPTION FOR ALIENS TAXABLE UNDER SUBSECTION (a)(2).—Subparagraph (A) shall not apply in the case of any nonresident alien individual subject to tax under subsection (a)(2).

"(C) SHORT-TERM CAPITAL GAIN DIVIDEND.—For purposes of this paragraph, a short-term capital gain dividend is any dividend (or part thereof) which is designated by the regulated investment company as a short-term capital gain dividend in a written notice mailed to its shareholders not later than 60 days after the close of its taxable year. If the aggregate amount so designated with respect to a taxable year of the company (including amounts so designated with respect to dividends paid after the close of the taxable year described in section 855) is greater than the qualified short-term gain of the company for such taxable year, the portion of each distribution which shall be a short-term capital gain dividend shall be only that portion of the amounts so designated which such qualified short-term gain bears to the aggregate amount so designated.

"(D) QUALIFIED SHORT-TERM GAIN.—For purposes of subparagraph (C), the term 'qualified short-term gain' means the excess of the net short-term capital gain of the regulated investment company for the taxable year over the net long-term capital loss (if any) of such company for such taxable year. For purposes of this subparagraph—

"(i) the net short-term capital gain of the regulated investment company shall be computed by treating any short-term capital gain dividend includible in gross income with respect to stock of another regulated investment company as a short-term capital gain, and

"(ii) the excess of the net short-term capital gain for a taxable year over the net long-term capital loss for

a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss or net short-term capital loss attributable to transactions after October 31 of such year, and any such net capital loss or net short-term capital loss shall be treated as arising on the 1st day of the next taxable year.

To the extent provided in regulations, clause (ii) shall apply also for purposes of computing the taxable income of the regulated investment company.".

(2) FOREIGN CORPORATIONS.—Section 881 (relating to tax on income of foreign corporations not connected with United States business) is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) TAX NOT TO APPLY TO CERTAIN DIVIDENDS OF REGULATED INVESTMENT COMPANIES.—

"(1) INTEREST-RELATED DIVIDENDS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no tax shall be imposed under paragraph (1) of subsection (a) on any interest-related dividend (as defined in section 871(k)(1)) received from a regulated investment company.

"(B) EXCEPTION.—Subparagraph (A) shall not apply—

"(i) to any dividend referred to in section 871(k)(1)(B), and

"(ii) to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company from a person who is a related person (within the meaning of section 864(d)(4)) with respect to such controlled foreign corporation.

"(C) TREATMENT OF DIVIDENDS RECEIVED BY CONTROLLED FOREIGN CORPORATIONS.—The rules of subsection (c)(5)(A) shall apply to any interest-related dividend received by a controlled foreign corporation (within the meaning of section 957(a)) to the extent such dividend is attributable to interest received by the regulated investment company which is described in clause (ii) of section 871(k)(1)(E) (and not described in clause (i), (iii), or the last sentence of such section).

"(2) SHORT-TERM CAPITAL GAIN DIVIDENDS.—No tax shall be imposed under paragraph (1) of subsection (a) on any short-term capital gain dividend (as defined in section 871(k)(2)) received from a regulated investment company.".

(3) WITHHOLDING TAXES.—

(A) Section 1441(c) (relating to exceptions) is amended by adding at the end the following new paragraph:

"(12) CERTAIN DIVIDENDS RECEIVED FROM REGULATED INVESTMENT COMPANIES.—

"(A) IN GENERAL.—No tax shall be required to be deducted and withheld under subsection (a) from any amount

exempt from the tax imposed by section 871(a)(1)(A) by reason of section 871(k).

"(B) SPECIAL RULE.—For purposes of subparagraph (A), clause (i) of section 871(k)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause. A similar rule shall apply with respect to the exception contained in section 871(k)(2)(B).".

(B) Section 1442(a) (relating to withholding of tax on foreign corporations) is amended—

(i) by striking "and the reference in section 1441(c)(10)" and inserting "the reference in section 1441(c)(10)", and

(ii) by inserting before the period at the end the following: ", and the references in section 1441(c)(12) to sections 871(a) and 871(k) shall be treated as referring to sections 881(a) and 881(e) (except that for purposes of applying subparagraph (A) of section 1441(c)(12), as so modified, clause (ii) of section 881(e)(1)(B) shall not apply to any dividend unless the regulated investment company knows that such dividend is a dividend referred to in such clause)".

(b) ESTATE TAX TREATMENT OF INTEREST IN CERTAIN REGULATED INVESTMENT COMPANIES.—Section 2105 (relating to property without the United States for estate tax purposes) is amended by adding at the end the following new subsection:

"(d) STOCK IN A RIC.—

"(1) IN GENERAL.—For purposes of this subchapter, stock in a regulated investment company (as defined in section 851) owned by a nonresident not a citizen of the United States shall not be deemed property within the United States in the proportion that, at the end of the quarter of such investment company's taxable year immediately preceding a decedent's date of death (or at such other time as the Secretary may designate in regulations), the assets of the investment company that were qualifying assets with respect to the decedent bore to the total assets of the investment company.

"(2) QUALIFYING ASSETS.—For purposes of this subsection, qualifying assets with respect to a decedent are assets that, if owned directly by the decedent, would have been—

"(A) amounts, deposits, or debt obligations described in subsection (b) of this section,

"(B) debt obligations described in the last sentence of section 2104(c), or

"(C) other property not within the United States.".

(c) TREATMENT OF REGULATED INVESTMENT COMPANIES UNDER SECTION 897.—

(1) Paragraph (1) of section 897(h) is amended by striking "REIT" each place it appears and inserting "qualified investment entity".

(2) Paragraphs (2) and (3) of section 897(h) are amended to read as follows:

"(2) SALE OF STOCK IN DOMESTICALLY CONTROLLED ENTITY NOT TAXED.—The term 'United States real property interest'

does not include any interest in a domestically controlled qualified investment entity.

"(3) DISTRIBUTIONS BY DOMESTICALLY CONTROLLED QUALIFIED INVESTMENT ENTITIES.—In the case of a domestically controlled qualified investment entity, rules similar to the rules of subsection (d) shall apply to the foreign ownership percentage of any gain.".

(3) Subparagraphs (A) and (B) of section 897(h)(4) are amended to read as follows:

"(A) QUALIFIED INVESTMENT ENTITY.—The term 'qualified investment entity' means any real estate investment trust and any regulated investment company.

"(B) DOMESTICALLY CONTROLLED.—The term 'domestically controlled qualified investment entity' means any qualified investment entity in which at all times during the testing period less than 50 percent in value of the stock was held directly or indirectly by foreign persons.".

(4) Subparagraphs (C) and (D) of section 897(h)(4) are each amended by striking "REIT" and inserting "qualified investment entity".

(5) The subsection heading for subsection (h) of section 897 is amended by striking "REITS" and inserting "CERTAIN INVESTMENT ENTITIES".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to dividends with respect to taxable years of regulated investment companies beginning after December 31, 2004.

(2) ESTATE TAX TREATMENT.—The amendment made by subsection (b) shall apply to estates of decedents dying after December 31, 2004.

(3) CERTAIN OTHER PROVISIONS.—The amendments made by subsection (c) (other than paragraph (1) thereof) shall take effect on January 1, 2005.

SEC. 908. REPEAL OF SPECIAL RULES FOR APPLYING FOREIGN TAX CREDIT IN CASE OF FOREIGN OIL AND GAS INCOME.

(a) IN GENERAL.—Section 907 (relating to special rules in case of foreign oil and gas income) is repealed.

(b) CONFORMING AMENDMENTS.—

(1) Each of the following provisions are amended by striking "907,":

(A) Section 245(a)(10).

(B) Section 865(h)(1)(B).

(C) Section 904(d)(1).

(D) Section 904(g)(10)(A).

(2) Section 904(f)(5)(E)(iii) is amended by inserting ", as in effect before its repeal by the Taxpayer Refund and Relief Act of 1999" after "section 907(c)(4)(B)".

(3) Section 954(g)(1) is amended by inserting ", as in effect before its repeal by the Taxpayer Refund and Relief Act of 1999" after "907(c)".

(4) Section 6501(i) is amended—

(A) by striking ", or under section 907(f) (relating to carryback and carryover of disallowed oil and gas extraction taxes)", and

(B) by striking "or 907(f)".

(5) The table of sections for subpart A of part III of subchapter N of chapter 1 is amended by striking the item relating to section 907.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2007.

SEC. 909. ADVANCE PRICING AGREEMENTS TREATED AS CONFIDENTIAL TAXPAYER INFORMATION.

(a) IN GENERAL.—

(1) TREATMENT AS RETURN INFORMATION.—Paragraph (2) of section 6103(b) (defining return information) is amended by striking "and" at the end of subparagraph (A), by inserting "and" at the end of subparagraph (B), and by inserting after subparagraph (B) the following new subparagraph:

"(C) any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement,".

(2) EXCEPTION FROM PUBLIC INSPECTION AS WRITTEN DETERMINATION.—Paragraph (1) of section 6110(b) (defining written determination) is amended by adding at the end the following new sentence: "Such term shall not include any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement.".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on the date of the enactment of this Act.

(b) ANNUAL REPORT REGARDING ADVANCE PRICING AGREEMENTS.—

(1) IN GENERAL.—Not later than 90 days after the end of each calendar year, the Secretary of the Treasury shall prepare and publish a report regarding advance pricing agreements.

(2) CONTENTS OF REPORT.—The report shall include the following for the calendar year to which such report relates:

(A) Information about the structure, composition, and operation of the advance pricing agreement program office.

(B) A copy of each model advance pricing agreement.

(C) The number of—

(i) applications filed during such calendar year for advanced pricing agreements;

(ii) advance pricing agreements executed cumulatively to date and during such calendar year;

(iii) renewals of advanced pricing agreements issued;

(iv) pending requests for advance pricing agreements;

(v) pending renewals of advance pricing agreements;

(vi) for each of the items in clauses (ii) through (v), the number that are unilateral, bilateral, and multilateral, respectively;

(vii) advance pricing agreements revoked or canceled, and the number of withdrawals from the advance pricing agreement program; and

(viii) advanced pricing agreements finalized or renewed by industry.

(D) General descriptions of—

(i) the nature of the relationships between the related organizations, trades, or businesses covered by advance pricing agreements;

(ii) the covered transactions and the business functions performed and risks assumed by such organizations, trades, or businesses;

(iii) the related organizations, trades, or businesses whose prices or results are tested to determine compliance with transfer pricing methodologies prescribed in advanced pricing agreements;

(iv) methodologies used to evaluate tested parties and transactions and the circumstances leading to the use of those methodologies;

(v) critical assumptions made and sources of comparables used;

(vi) comparable selection criteria and the rationale used in determining such criteria;

(vii) the nature of adjustments to comparables or tested parties;

(viii) the nature of any ranges agreed to, including information regarding when no range was used and why, when interquartile ranges were used, and when there was a statistical narrowing of the comparables;

(ix) adjustment mechanisms provided to rectify results that fall outside of the agreed upon advance pricing agreement range;

(x) the various term lengths for advance pricing agreements, including rollback years, and the number of advance pricing agreements with each such term length;

(xi) the nature of documentation required; and

(xii) approaches for sharing of currency or other risks.

(E) Statistics regarding the amount of time taken to complete new and renewal advance pricing agreements.

(F) A detailed description of the Secretary of the Treasury's efforts to ensure compliance with existing advance pricing agreements.

(3) CONFIDENTIALITY.—The reports required by this subsection shall be treated as authorized by the Internal Revenue Code of 1986 for purposes of section 6103 of such Code, but the reports shall not include information—

(A) which would not be permitted to be disclosed under section 6110(c) of such Code if such report were a written determination as defined in section 6110 of such Code, or

(B) which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

(4) FIRST REPORT.—The report for calendar year 1999 shall include prior calendar years after 1990.

(c) USER FEE.—Section 7527, as added by title XV of this Act, is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) ADVANCE PRICING AGREEMENTS.—

"(1) IN GENERAL.—In addition to any fee otherwise imposed under this section, the fee imposed for requests for advance pricing agreements shall be increased by $500.

"(2) REDUCED FEE FOR SMALL BUSINESSES.—The Secretary shall provide an appropriate reduction in the amount imposed by reason of paragraph (1) for requests for advance pricing agreements for small businesses.".

(d) REGULATIONS.—The Secretary of the Treasury or the Secretary's delegate shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 6103(b)(2)(C), and the last sentence of section 6110(b)(1), of the Internal Revenue Code of 1986, as added by this section.

SEC. 910. INCREASE IN DOLLAR LIMITATION ON SECTION 911 EXCLUSION.

(a) GENERAL RULE.—The table contained in clause (i) of section 911(b)(2)(D) is amended to read as follows:

"For calendar year—	***The exclusion amount is—***
2000	*$76,000*
2001	*78,000*
2002	*80,000*
2003	*83,000*
2004	*86,000*
2005	*89,000*
2006	*92,000*
2007 and thereafter	*95,000.".*

(b) CONFORMING AMENDMENT.—Clause (ii) of section 911(b)(2)(D) is amended by striking "$80,000" and inserting "$95,000".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 911. AIRLINE MILEAGE AWARDS TO CERTAIN FOREIGN PERSONS.

(a) IN GENERAL.—Paragraph (3) of section 4261(e) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) MILEAGE AWARDS ISSUED TO INDIVIDUALS RESIDING OUTSIDE THE UNITED STATES.—The tax imposed by subsection (a) shall not apply to amounts attributable to mileage awards credited to individuals whose mailing addresses on record with the person providing the right to air transportation are outside the United States."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid after December 31, 2004.

TITLE X—PROVISIONS RELATING TO TAX-EXEMPT ORGANIZATIONS

SEC. 1001. EXEMPTION FROM INCOME TAX FOR STATE-CREATED ORGANIZATIONS PROVIDING PROPERTY AND CASUALTY INSURANCE FOR PROPERTY FOR WHICH SUCH COVERAGE IS OTHERWISE UNAVAILABLE.

(a) IN GENERAL.—Subsection (c) of section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by adding at the end the following new paragraph:

"(28)(A) Any association created before January 1, 1999, by State law and organized and operated exclusively to provide property and casualty insurance coverage for property located within the State for which the State has determined that coverage in the authorized insurance market is limited or unavailable at reasonable rates, if—

"(i) no part of the net earnings of which inures to the benefit of any private shareholder or individual,

"(ii) except as provided in clause (v), no part of the assets of which may be used for, or diverted to, any purpose other than—

"(I) to satisfy, in whole or in part, the liability of the association for, or with respect to, claims made on policies written by the association,

"(II) to invest in investments authorized by applicable law,

"(III) to pay reasonable and necessary administration expenses in connection with the establishment and operation of the association and the processing of claims against the association, or

"(IV) to make remittances pursuant to State law to be used by the State to provide for the payment of claims on policies written by the association, purchase reinsurance covering losses under such policies, or to support governmental programs to prepare for or mitigate the effects of natural catastrophic events,

"(iii) the State law governing the association permits the association to levy assessments on insurance companies authorized to sell property and casualty insurance in the State, or on property and casualty insurance policyholders with insurable interests in property located in the State to fund deficits of the association, including the creation of reserves,

"(iv) the plan of operation of the association is subject to approval by the chief executive officer or other official of the State, by the State legislature, or both, and

"(v) the assets of the association revert upon dissolution to the State, the State's designee, or an entity designated by the State law governing the association, or State law does not permit the dissolution of the association.

"(B)(i) An entity described in clause (ii) shall be disregarded as a separate entity and treated as part of the association described in subparagraph (A) from which it receives remittances described in clause (ii) if an election is made within

30 days after the date that such association is determined to be exempt from tax.

"(ii) An entity is described in this clause if it is an entity or fund created before January 1, 1999, pursuant to State law and organized and operated exclusively to receive, hold, and invest remittances from an association described in subparagraph (A) and exempt from tax under subsection (a), to make disbursements to pay claims on insurance contracts issued by such association, and to make disbursements to support governmental programs to prepare for or mitigate the effects of natural catastrophic events.".

(b) UNRELATED BUSINESS TAXABLE INCOME.—Subsection (a) of section 512 (relating to unrelated business taxable income) is amended by adding at the end the following new paragraph:

"(6) SPECIAL RULE APPLICABLE TO ORGANIZATIONS DESCRIBED IN SECTION 501(C)(28).—In the case of an organization described in section 501(c)(28), the term 'unrelated business taxable income' means taxable income for a taxable year computed without the application of section 501(c)(28) if at the end of the immediately preceding taxable year the organization's net equity exceeded 15 percent of the total coverage in force under insurance contracts issued by the organization and outstanding at the end of such preceding year.".

(c) TRANSITIONAL RULE.—No income or gain shall be recognized by an association as a result of a change in status to that of an association described by section 501(c)(28) of the Internal Revenue Code of 1986, as amended by subsection (a).

(d) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1999.

SEC. 1002. MODIFICATION OF SPECIAL ARBITRAGE RULE FOR CERTAIN FUNDS.

(a) IN GENERAL.—Paragraph (1) of section 648 of the Tax Reform Act of 1984 is amended to read as follows:

"(1) such securities or obligations are held in a fund—

"(A) which, except to the extent of the investment earnings on such securities or obligations, cannot be used, under State constitutional or statutory restrictions continuously in effect since October 9, 1969, through the date of issue of the bond issue, to pay debt service on the bond issue or to finance the facilities that are to be financed with the proceeds of the bonds, or

"(B) the annual distributions from which cannot exceed 7 percent of the average fair market value of the assets held in such fund except to the extent distributions are necessary to pay debt service on the bond issue,".

(b) CONFORMING AMENDMENT.—Paragraph (3) of such section is amended by striking "the investment earnings of" and inserting "distributions from".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 2000.

SEC. 1003. EXEMPTION PROCEDURE FROM TAXES ON SELF-DEALING.

(a) IN GENERAL.—Subsection (d) of section 4941 (relating to taxes on self-dealing) is amended by adding at the end the following new paragraph:

"(3) SPECIAL EXEMPTION.—The Secretary shall establish an exemption procedure for purposes of this subsection. Pursuant to such procedure, the Secretary may grant a conditional or unconditional exemption of any disqualified person or transaction or class of disqualified persons or transactions, from all or part of the restrictions imposed by paragraph (1). The Secretary may not grant an exemption under this paragraph unless he finds that such exemption is—

"(A) administratively feasible,

"(B) in the interests of the private foundation, and

"(C) protective of the rights of the private foundation.

Before granting an exemption under this paragraph, the Secretary shall require adequate notice to be given to interested persons and shall publish notice in the Federal Register of the pendency of such exemption and shall afford interested persons an opportunity to present views.".

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

SEC. 1004. EXPANSION OF DECLARATORY JUDGMENT REMEDY TO TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Subsection (a) of section 7428 (relating to creation of remedy) is amended—

(1) in subparagraph (B) by inserting after "509(a))" the following: "or as a private operating foundation (as defined in section 4942(j)(3))", and

(2) by amending subparagraph (C) to read as follows:

"(C) with respect to the initial qualification or continuing qualification of an organization as an organization described in section 501(c) (other than paragraph (3)) which is exempt from tax under section 501(a), or".

(b) COURT JURISDICTION.—Subsection (a) of section 7428 is amended in the material following paragraph (2) by striking "United States Tax Court, the United States Claims Court, or the district court of the United States for the District of Columbia" and inserting the following: "United States Tax Court (in the case of any such determination or failure) or the United States Claims Court or the district court of the United States for the District of Columbia (in the case of a determination or failure with respect to an issue referred to in subparagraph (A) or (B) of paragraph (1)),".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to pleadings filed with respect to determinations (or requests for determinations) made after the date of the enactment of this Act.

SEC. 1005. MODIFICATIONS TO SECTION 512(b)(13).

(a) IN GENERAL.—Paragraph (13) of section 512(b) is amended by redesignating subparagraph (E) as subparagraph (F) and by inserting after subparagraph (D) the following new paragraph:

"(E) PARAGRAPH TO APPLY ONLY TO EXCESS PAYMENTS.—

"(i) IN GENERAL.—Subparagraph (A) shall apply only to the portion of a specified payment received by the controlling organization that exceeds the amount which would have been paid if such payment met the requirements prescribed under section 482.

"(ii) ADDITION TO TAX FOR VALUATION MISSTATEMENTS.—The tax imposed by this chapter on the controlling organization shall be increased by an amount equal to 20 percent of such excess.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by this section shall apply to payments received or accrued after December 31, 1999.

(2) PAYMENTS SUBJECT TO BINDING CONTRACT TRANSITION RULE.—If the amendments made by section 1041 of the Taxpayer Relief Act of 1997 do not apply to any amount received or accrued after the date of the enactment of this Act under any contract described in subsection (b)(2) of such section, such amendments also shall not apply to amounts received or accrued under such contract before January 1, 2000.

SEC. 1006. MILEAGE REIMBURSEMENTS TO CHARITABLE VOLUNTEERS EXCLUDED FROM GROSS INCOME.

(a) IN GENERAL.—Part III of subchapter B of chapter 1 is amended by inserting after section 138 the following new section:

"SEC. 138A. MILEAGE REIMBURSEMENTS TO CHARITABLE VOLUNTEERS.

"(a) IN GENERAL.—Gross income of an individual does not include amounts received, from an organization described in section 170(c), as reimbursement of operating expenses with respect to use of a passenger automobile for the benefit of such organization for which a deduction would otherwise be allowable under section 170. The preceding sentence shall apply only to the extent that such reimbursement would be deductible under section 274(d) (determined by applying the standard business mileage rate established pursuant to section 274(d)) if the organization were not so described and such individual were an employee of such organization.

"(b) NO DOUBLE BENEFIT.—Subsection (a) shall not apply with respect to any expenses if the individual claims a deduction or credit for such expenses under any other provision of this title.

"(c) EXEMPTION FROM REPORTING REQUIREMENTS.—Section 6041 shall not apply with respect to reimbursements excluded from income under subsection (a).".

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter B of chapter 1 is amended by inserting after the item relating to section 138 the following new items:

"Sec. 138A. Reimbursement for use of passenger automobile for charity.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1007. CHARITABLE CONTRIBUTION DEDUCTION FOR CERTAIN EXPENSES INCURRED IN SUPPORT OF NATIVE ALASKAN SUBSISTENCE WHALING.

(a) IN GENERAL.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsection (m) as

subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) EXPENSES PAID BY CERTAIN WHALING CAPTAINS IN SUPPORT OF NATIVE ALASKAN SUBSISTENCE WHALING.—

"(1) IN GENERAL.—In the case of an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities and who engages in such activities during the taxable year, the amount described in paragraph (2) (to the extent such amount does not exceed $7,500 for the taxable year) shall be treated for purposes of this section as a charitable contribution.

"(2) AMOUNT DESCRIBED.—

"(A) IN GENERAL.—The amount described in this paragraph is the aggregate of the reasonable and necessary whaling expenses paid by the taxpayer during the taxable year in carrying out sanctioned whaling activities.

"(B) WHALING EXPENSES.—For purposes of subparagraph (A), the term 'whaling expenses' includes expenses for—

"(i) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities,

"(ii) the supplying of food for the crew and other provisions for carrying out such activities, and

"(iii) storage and distribution of the catch from such activities.

"(3) SANCTIONED WHALING ACTIVITIES.—For purposes of this subsection, the term 'sanctioned whaling activities' means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission.".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1999.

SEC. 1008. SIMPLIFICATION OF LOBBYING EXPENDITURE LIMITATION.

(a) REPEAL OF GRASSROOTS EXPENDITURE LIMIT.—Paragraph (1) of section 501(h) (relating to expenditures by public charities to influence legislation) is amended to read as follows:

"(1) GENERAL RULE.—In the case of an organization to which this subsection applies, exemption from taxation under subsection (a) shall be denied because a substantial part of the activities of such organization consists of carrying on propaganda, or otherwise attempting, to influence legislation, but only if such organization normally makes lobbying expenditures in excess of the lobbying ceiling amount for such organization for each taxable year.".

(b) CONFORMING AMENDMENTS.—

(1) Section 501(h)(2) is amended by striking subparagraphs (C) and (D).

(2) Section 4911(b) is amended to read as follows:

"(b) EXCESS LOBBYING EXPENDITURES.—For purposes of this section, the term 'excess lobbying expenditures' means, for a taxable year, the amount by which the lobbying expenditures made by the

organization during the taxable year exceed the lobbying nontaxable amount for such organization for such taxable year.".

(3) Section 4911(c) is amended by striking paragraphs (3) and (4).

(4) Paragraph (1)(A) of section 4911(f) is amended by striking "limits of section 501(h)(1) have" and inserting "limit of section 501(h)(1) has".

(5) Paragraph (1)(C) of section 4911(f) is amended by striking "limits of section 501(h)(1) are" and inserting "limit of section 501(h)(1) is".

(6) Paragraphs (4)(A) and (4)(B) of section 4911(f) are each amended by striking "limits of section 501(h)(1)" and inserting "limit of section 501(h)(1)".

(7) Paragraph (8) of section 6033(b) (relating to certain organizations described in section 501(c)(3)) is amended by inserting "and" at the end of subparagraph (A) and by striking subparagraphs (C) and (D).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1009. TAX-FREE DISTRIBUTIONS FROM INDIVIDUAL RETIREMENT ACCOUNTS FOR CHARITABLE PURPOSES.

(a) IN GENERAL.—Subsection (d) of section 408 (relating to individual retirement accounts) is amended by adding at the end the following new paragraph:

"(8) DISTRIBUTIONS FOR CHARITABLE PURPOSES.—

"(A) IN GENERAL.—In the case of a qualified charitable distribution from an individual retirement account to an organization described in section 170(c), no amount shall be includible in the gross income of the distributee.

"(B) QUALIFIED CHARITABLE DISTRIBUTION.—For purposes of this paragraph, the term 'qualified charitable distribution' means any distribution from an individual retirement account—

"(i) which is made on or after the date that the individual for whose benefit the account is maintained has attained age 70½, and

"(ii) which is a charitable contribution (as defined in section 170(c)) made directly from the account to an organization or entity described in section 170(c).

"(C) DENIAL OF DEDUCTION.—The amount allowable as a deduction to the taxpayer for the taxable year under section 170 for qualified charitable distributions shall be reduced (but not below zero) by the sum of the amounts of the qualified charitable distributions during such year which (but for this paragraph) would have been includible in the gross income of the taxpayer for such year.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 2002.

TITLE XI—REAL ESTATE PROVISIONS

Subtitle A—Improvements in Low-Income Housing Credit

SEC. 1101. MODIFICATION OF STATE CEILING ON LOW-INCOME HOUSING CREDIT.

(a) IN GENERAL.—Clauses (i) and (ii) of section 42(h)(3)(C) (relating to State housing credit ceiling) are amended to read as follows:

"(i) the unused State housing credit ceiling (if any) of such State for the preceding calendar year,

"(ii) the greater of—

"(I) the applicable amount under subparagraph (H) multiplied by the State population, or

"(II) $2,000,000,".

(b) APPLICABLE AMOUNT.—Paragraph (3) of section 42(h) (relating to housing credit dollar amount for agencies) is amended by adding at the end the following new subparagraph:

"(H) APPLICABLE AMOUNT OF STATE CEILING.—For purposes of subparagraph (C)(ii), the applicable amount shall be determined under the following table:

"For calendar year:	***The applicable amount is:***
2000	*$1.35*
2001	*1.45*
2002	*1.55*
2003	*1.65*
2004 and thereafter	*1.75.*

(d) ADJUSTMENT OF STATE CEILING FOR INCREASES IN COST-OF-LIVING.—Paragraph (3) of section 42(h) (relating to housing credit dollar amount for agencies), as amended by subsection (c), is amended by adding at the end the following new subparagraph:

"(I) COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—In the case of a calendar year after 2004, the $2,000,000 in subparagraph (C) and the $1.75 amount in subparagraph (H) shall each be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year by substituting 'calendar year 2003' for 'calendar year 1992' in subparagraph (B) thereof.

"(ii) ROUNDING.—

"(I) In the case of the amount in subparagraph (C), any increase under clause (i) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

"(II) In the case of the amount in subparagraph (H), any increase under clause (i) which is not a multiple of 5 cents shall be rounded to the next lowest multiple of 5 cents.".

(e) CONFORMING AMENDMENTS.—

(1) Section 42(h)(3)(C), as amended by subsection (a), is amended—

(A) by striking "clause (ii)" in the matter following clause (iv) and inserting "clause (i)", and

(B) by striking "clauses (i)" in the matter following clause (iv) and inserting "clauses (ii)".

(2) Section 42(h)(3)(D)(ii) is amended—

(A) by striking "subparagraph (C)(ii)" and inserting "subparagraph (C)(i)", and

(B) by striking "clauses (i)" in subclause (II) and inserting "clauses (ii)".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years after 2000 but shall not take effect if sections 1102 and 1103 do not take effect.

SEC. 1102. MODIFICATION OF CRITERIA FOR ALLOCATING HOUSING CREDITS AMONG PROJECTS.

(a) SELECTION CRITERIA.—Subparagraph (C) of section 42(m)(1) (relating to certain selection criteria must be used) is amended—

(1) by inserting ", including whether the project includes the use of existing housing as part of a community revitalization plan" before the comma at the end of clause (iii), and

(2) by striking clauses (v), (vi), and (vii) and inserting the following new clauses:

"(v) tenant populations with special housing needs,

"(vi) public housing waiting lists,

"(vii) tenant populations of individuals with children, and

"(viii) projects intended for eventual tenant ownership.".

(b) PREFERENCE FOR COMMUNITY REVITALIZATION PROJECTS LOCATED IN QUALIFIED CENSUS TRACTS.—Clause (ii) of section 42(m)(1)(B) is amended by striking "and" at the end of subclause (I), by adding "and" at the end of subclause (II), and by inserting after subclause (II) the following new subclause:

"(III) projects which are located in qualified census tracts (as defined in subsection (d)(5)(C)) and the development of which contributes to a concerted community revitalization plan,".

SEC. 1103. ADDITIONAL RESPONSIBILITIES OF HOUSING CREDIT AGENCIES.

(a) MARKET STUDY; PUBLIC DISCLOSURE OF RATIONALE FOR NOT FOLLOWING CREDIT ALLOCATION PRIORITIES.—Subparagraph (A) of section 42(m)(1) (relating to responsibilities of housing credit agencies) is amended by striking "and" at the end of clause (i), by striking the period at the end of clause (ii) and inserting a comma, and by adding at the end the following new clauses:

"(iii) a comprehensive market study of the housing needs of low-income individuals in the area to be served by the project is conducted before the credit allocation is made and at the developer's expense by a disinterested party who is approved by such agency, and

"(iv) a written explanation is available to the general public for any allocation of a housing credit dollar amount which is not made in accordance with estab-

lished priorities and selection criteria of the housing credit agency.".

(b) SITE VISITS.—Clause (iii) of section 42(m)(1)(B) (relating to qualified allocation plan) is amended by inserting before the period "and in monitoring for noncompliance with habitability standards through regular site visits".

SEC. 1104. MODIFICATIONS TO RULES RELATING TO BASIS OF BUILDING WHICH IS ELIGIBLE FOR CREDIT.

(a) ADJUSTED BASIS TO INCLUDE PORTION OF CERTAIN BUILDINGS USED BY LOW-INCOME INDIVIDUALS WHO ARE NOT TENANTS AND BY PROJECT EMPLOYEES.—Paragraph (4) of section 42(d) (relating to special rules relating to determination of adjusted basis) is amended—

(1) by striking "subparagraph (B)" in subparagraph (A) and inserting "subparagraphs (B) and (C)",

(2) by redesignating subparagraph (C) as subparagraph (D), and

(3) by inserting after subparagraph (B) the following new subparagraph:

"(C) INCLUSION OF BASIS OF PROPERTY USED TO PROVIDE SERVICES FOR CERTAIN NONTENANTS.—

"(i) IN GENERAL.—The adjusted basis of any building located in a qualified census tract (as defined in paragraph (5)(C)) shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation and not otherwise taken into account) used throughout the taxable year in providing any community service facility.

"(ii) LIMITATION.—The increase in the adjusted basis of any building which is taken into account by reason of clause (i) shall not exceed 10 percent of the eligible basis of the qualified low-income housing project of which it is a part. For purposes of the preceding sentence, all community service facilities which are part of the same qualified low-income housing project shall be treated as 1 facility.

"(iii) COMMUNITY SERVICE FACILITY.—For purposes of this subparagraph, the term 'community service facility' means any facility designed to serve primarily individuals whose income is 60 percent or less of area median income (within the meaning of subsection (g)(1)(B)).".

(b) CERTAIN NATIVE AMERICAN HOUSING ASSISTANCE DISREGARDED IN DETERMINING WHETHER BUILDING IS FEDERALLY SUBSIDIZED FOR PURPOSES OF THE LOW-INCOME HOUSING CREDIT.—Subparagraph (E) of section 42(i)(2) (relating to determination of whether building is federally subsidized) is amended—

(1) in clause (i), by inserting "or the Native American Housing Assistance and Self-Determination Act of 1996 (25 U.S.C. 4101 et seq.) (as in effect on October 1, 1997)" after "this subparagraph)", and

(2) in the subparagraph heading, by inserting "OR NATIVE AMERICAN HOUSING ASSISTANCE" after "HOME ASSISTANCE".

SEC. 1105. OTHER MODIFICATIONS.

(a) ALLOCATION OF CREDIT LIMIT TO CERTAIN BUILDINGS.—

(1) The first sentence of section 42(h)(1)(E)(ii) is amended by striking "(as of" the first place it appears and inserting "(as of the later of the date which is 6 months after the date that the allocation was made or".

(2) The last sentence of section 42(h)(3)(C) is amended by striking "project which" and inserting "project which fails to meet the 10 percent test under paragraph (1)(E)(ii) on a date after the close of the calendar year in which the allocation was made or which".

(b) DETERMINATION OF WHETHER BUILDINGS ARE LOCATED IN HIGH COST AREAS.—The first sentence of section 42(d)(5)(C)(ii)(I) is amended—

(1) by inserting "either" before "in which 50 percent", and

(2) by inserting before the period "or which has a poverty rate of at least 25 percent".

SEC. 1106. CARRYFORWARD RULES.

(a) IN GENERAL.—Clause (ii) of section 42(h)(3)(D) (relating to unused housing credit carryovers allocated among certain States) is amended by striking "the excess" and all that follows and inserting "the excess (if any) of—

"(I) the unused State housing credit ceiling for the year preceding such year, over

"(II) the aggregate housing credit dollar amount allocated for such year.".

(b) CONFORMING AMENDMENT.—The second sentence of section 42(h)(3)(C) (relating to State housing credit ceiling) is amended by striking "clauses (i) and (iii)" and inserting "clauses (i) through (iv)".

SEC. 1107. EFFECTIVE DATE.

Except as otherwise provided in this subtitle, the amendments made by this subtitle shall apply to—

(1) housing credit dollar amounts allocated after December 31, 1999, and

(2) buildings placed in service after such date to the extent paragraph (1) of section 42(h) of the Internal Revenue Code of 1986 does not apply to any building by reason of paragraph (4) thereof, but only with respect to bonds issued after such date.

Subtitle B—Provisions Relating to Real Estate Investment Trusts

PART I—TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES

SEC. 1111. MODIFICATIONS TO ASSET DIVERSIFICATION TEST.

(a) IN GENERAL.—Subparagraph (B) of section 856(c)(4) is amended to read as follows:

"(B)(i) not more than 25 percent of the value of its total assets is represented by securities (other than those includible under subparagraph (A)), and

"(ii) except with respect to a taxable REIT subsidiary and securities includible under subparagraph (A)—

"(I) not more than 5 percent of the value of its total assets is represented by securities of any 1 issuer,

"(II) the trust does not hold securities possessing more than 10 percent of the total voting power of the outstanding securities of any 1 issuer, and

"(III) the trust does not hold securities having a value of more than 10 percent of the total value of the outstanding securities of any 1 issuer.".

(b) EXCEPTION FOR STRAIGHT DEBT SECURITIES.—Subsection (c) of section 856 is amended by adding at the end the following new paragraph:

"(7) STRAIGHT DEBT SAFE HARBOR IN APPLYING PARAGRAPH (4).—Securities of an issuer which are straight debt (as defined in section 1361(c)(5) without regard to subparagraph (B)(iii) thereof) shall not be taken into account in applying paragraph (4)(B)(ii)(III) if—

"(A) the issuer is an individual, or

"(B) the only securities of such issuer which are held by the trust or a taxable REIT subsidiary of the trust are straight debt (as so defined), or

"(C) the issuer is a partnership and the trust holds at least a 20 percent profits interest in the partnership.".

SEC. 1112. TREATMENT OF INCOME AND SERVICES PROVIDED BY TAXABLE REIT SUBSIDIARIES.

(a) INCOME FROM TAXABLE REIT SUBSIDIARIES NOT TREATED AS IMPERMISSIBLE TENANT SERVICE INCOME.—Clause (i) of section 856(d)(7)(C) (relating to exceptions to impermissible tenant service income) is amended by inserting "or through a taxable REIT subsidiary of such trust" after "income".

(b) CERTAIN INCOME FROM TAXABLE REIT SUBSIDIARIES NOT EXCLUDED FROM RENTS FROM REAL PROPERTY.—

(1) IN GENERAL.—Subsection (d) of section 856 (relating to rents from real property defined) is amended by adding at the end the following new paragraphs:

"(8) SPECIAL RULE FOR TAXABLE REIT SUBSIDIARIES.—For purposes of this subsection, amounts paid to a real estate investment trust by a taxable REIT subsidiary of such trust shall not be excluded from rents from real property by reason of paragraph (2)(B) if the requirements of either of the following subparagraphs are met:

"(A) LIMITED RENTAL EXCEPTION.—The requirements of this subparagraph are met with respect to any property if at least 90 percent of the leased space of the property is rented to persons other than taxable REIT subsidiaries of such trust and other than persons described in section 856(d)(2)(B). The preceding sentence shall apply only to the extent that the amounts paid to the trust as rents from real property (as defined in paragraph (1) without regard to paragraph (2)(B)) from such property are substantially

comparable to such rents made by the other tenants of the trust's property for comparable space.

"(B) EXCEPTION FOR CERTAIN LODGING FACILITIES.—The requirements of this subparagraph are met with respect to an interest in real property which is a qualified lodging facility leased by the trust to a taxable REIT subsidiary of the trust if the property is operated on behalf of such subsidiary by a person who is an eligible independent contractor.

"(9) ELIGIBLE INDEPENDENT CONTRACTOR.—For purposes of paragraph (8)(B)—

"(A) IN GENERAL.—The term 'eligible independent contractor' means, with respect to any qualified lodging facility, any independent contractor if, at the time such contractor enters into a management agreement or other similar service contract with the taxable REIT subsidiary to operate the facility, such contractor (or any related person) is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not a related person with respect to the real estate investment trust or the taxable REIT subsidiary.

"(B) SPECIAL RULES.—Solely for purposes of this paragraph and paragraph (8)(B), a person shall not fail to be treated as an independent contractor with respect to any qualified lodging facility by reason of any of the following:

"(i) The taxable REIT subsidiary bears the expenses for the operation of the facility pursuant to the management agreement or other similar service contract.

"(ii) The taxable REIT subsidiary receives the revenues from the operation of such facility, net of expenses for such operation and fees payable to the operator pursuant to such agreement or contract.

"(iii) The real estate investment trust receives income from such person with respect to another property that is attributable to a lease of such other property to such person that was in effect as of the later of—

"(I) January 1, 1999, or

"(II) the earliest date that any taxable REIT subsidiary of such trust entered into a management agreement or other similar service contract with such person with respect to such qualified lodging facility.

"(C) RENEWALS, ETC., OF EXISTING LEASES.—For purposes of subparagraph (B)(iii)—

"(i) a lease shall be treated as in effect on January 1, 1999, without regard to its renewal after such date, so long as such renewal is pursuant to the terms of such lease as in effect on whichever of the dates under subparagraph (B)(iii) is the latest, and

"(ii) a lease of a property entered into after whichever of the dates under subparagraph (B)(iii) is the latest shall be treated as in effect on such date if—

"(I) on such date, a lease of such property from the trust was in effect, and

"(II) under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).

"(D) QUALIFIED LODGING FACILITY.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified lodging facility' means any lodging facility unless wagering activities are conducted at or in connection with such facility by any person who is engaged in the business of accepting wagers and who is legally authorized to engage in such business at or in connection with such facility.

"(ii) LODGING FACILITY.—The term 'lodging facility' means a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis.

"(iii) CUSTOMARY AMENITIES AND FACILITIES.—The term 'lodging facility' includes customary amenities and facilities operated as part of, or associated with, the lodging facility so long as such amenities and facilities are customary for other properties of a comparable size and class owned by other owners unrelated to such real estate investment trust.

"(E) OPERATE INCLUDES MANAGE.—References in this paragraph to operating a property shall be treated as including a reference to managing the property.

"(F) RELATED PERSON.—Persons shall be treated as related to each other if such persons are treated as a single employer under subsection (a) or (b) of section 52.".

(2) CONFORMING AMENDMENT.—Subparagraph (B) of section 856(d)(2) is amended by inserting "except as provided in paragraph (8)," after "(B)".

(3) DETERMINING RENTS FROM REAL PROPERTY.—

(A)(i) Paragraph (1) of section 856(d) is amended by striking "adjusted bases" each place it occurs and inserting "fair market values".

(ii) The amendment made by this subparagraph shall apply to taxable years beginning after December 31, 2000.

(B)(i) Clause (i) of section 856(d)(2)(B) is amended by striking "number" and inserting "value".

(ii) The amendment made by this subparagraph shall apply to amounts received or accrued in taxable years beginning after December 31, 2000, except for amounts paid pursuant to leases in effect on July 12, 1999, or pursuant to a binding contract in effect on such date and at all times thereafter.

SEC. 1113. TAXABLE REIT SUBSIDIARY.

(a) IN GENERAL.—Section 856 is amended by adding at the end the following new subsection:

"(l) TAXABLE REIT SUBSIDIARY.—For purposes of this part—

"(1) IN GENERAL.—The term 'taxable REIT subsidiary' means, with respect to a real estate investment trust, a corporation (other than a real estate investment trust) if—

"(A) such trust directly or indirectly owns stock in such corporation, and

"(B) such trust and such corporation jointly elect that such corporation shall be treated as a taxable REIT subsidiary of such trust for purposes of this part.

Such an election, once made, shall be irrevocable unless both such trust and corporation consent to its revocation. Such election, and any revocation thereof, may be made without the consent of the Secretary.

"(2) 35 PERCENT OWNERSHIP IN ANOTHER TAXABLE REIT SUBSIDIARY.—The term 'taxable REIT subsidiary' includes, with respect to any real estate investment trust, any corporation (other than a real estate investment trust) with respect to which a taxable REIT subsidiary of such trust owns directly or indirectly—

"(A) securities possessing more than 35 percent of the total voting power of the outstanding securities of such corporation, or

"(B) securities having a value of more than 35 percent of the total value of the outstanding securities of such corporation.

The preceding sentence shall not apply to a qualified REIT subsidiary (as defined in subsection (i)(2)). The rule of section 856(c)(7) shall apply for purposes of subparagraph (B).

"(3) EXCEPTIONS.—The term 'taxable REIT subsidiary' shall not include—

"(A) any corporation which directly or indirectly operates or manages a lodging facility or a health care facility, and

"(B) any corporation which directly or indirectly provides to any other person (under a franchise, license, or otherwise) rights to any brand name under which any lodging facility or health care facility is operated.

Subparagraph (B) shall not apply to rights provided to an eligible independent contractor to operate or manage a lodging facility if such rights are held by such corporation as a franchisee, licensee, or in a similar capacity and such lodging facility is either owned by such corporation or is leased to such corporation from the real estate investment trust.

"(4) DEFINITIONS.—For purposes of paragraph (3)—

"(A) LODGING FACILITY.—The term 'lodging facility' has the meaning given to such term by paragraph (9)(D)(ii).

"(B) HEALTH CARE FACILITY.—The term 'health care facility' has the meaning given to such term by subsection (e)(6)(D)(ii).".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 856(i) is amended by adding at the end the following new sentence: "Such term shall not include a taxable REIT subsidiary.".

SEC. 1114. LIMITATION ON EARNINGS STRIPPING.

Paragraph (3) of section 163(j) (relating to limitation on deduction for interest on certain indebtedness) is amended by striking

"and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) any interest paid or accrued (directly or indirectly) by a taxable REIT subsidiary (as defined in section 856(l)) of a real estate investment trust to such trust.".

SEC. 1115. 100 PERCENT TAX ON IMPROPERLY ALLOCATED AMOUNTS.

(a) IN GENERAL.—Subsection (b) of section 857 (relating to method of taxation of real estate investment trusts and holders of shares or certificates of beneficial interest) is amended by redesignating paragraphs (7) and (8) as paragraphs (8) and (9), respectively, and by inserting after paragraph (6) the following new paragraph:

"(7) INCOME FROM REDETERMINED RENTS, REDETERMINED DEDUCTIONS, AND EXCESS INTEREST.—

"(A) IMPOSITION OF TAX.—There is hereby imposed for each taxable year of the real estate investment trust a tax equal to 100 percent of redetermined rents, redetermined deductions, and excess interest.

"(B) REDETERMINED RENTS.—

"(i) IN GENERAL.—The term 'redetermined rents' means rents from real property (as defined in subsection 856(d)) the amount of which would (but for subparagraph (E)) be reduced on distribution, apportionment, or allocation under section 482 to clearly reflect income as a result of services furnished or rendered by a taxable REIT subsidiary of the real estate investment trust to a tenant of such trust.

"(ii) EXCEPTION FOR CERTAIN SERVICES.—Clause (i) shall not apply to amounts received directly or indirectly by a real estate investment trust for services described in paragraph (1)(B) or (7)(C)(i) of section 856(d).

"(iii) EXCEPTION FOR DE MINIMIS AMOUNTS.—Clause (i) shall not apply to amounts described in section 856(d)(7)(A) with respect to a property to the extent such amounts do not exceed the one percent threshold described in section 856(d)(7)(B) with respect to such property.

"(iv) EXCEPTION FOR COMPARABLY PRICED SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

"(I) such subsidiary renders a significant amount of similar services to persons other than such trust and tenants of such trust who are unrelated (within the meaning of section 856(d)(8)(F)) to such subsidiary, trust, and tenants, but

"(II) only to the extent the charge for such service so rendered is substantially comparable to the charge for the similar services rendered to persons referred to in subclause (I).

"(v) EXCEPTION FOR CERTAIN SEPARATELY CHARGED SERVICES.—Clause (i) shall not apply to any service

rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if—

"(I) the rents paid to the trust by tenants (leasing at least 25 percent of the net leasable space in the trust's property) who are not receiving such service from such subsidiary are substantially comparable to the rents paid by tenants leasing comparable space who are receiving such service from such subsidiary, and

"(II) the charge for such service from such subsidiary is separately stated.

"(vi) EXCEPTION FOR CERTAIN SERVICES BASED ON SUBSIDIARY'S INCOME FROM THE SERVICES.—Clause (i) shall not apply to any service rendered by a taxable REIT subsidiary of a real estate investment trust to a tenant of such trust if the gross income of such subsidiary from such service is not less than 150 percent of such subsidiary's direct cost in furnishing or rendering the service.

"(vii) EXCEPTIONS GRANTED BY SECRETARY.—The Secretary may waive the tax otherwise imposed by subparagraph (A) if the trust establishes to the satisfaction of the Secretary that rents charged to tenants were established on an arms' length basis even though a taxable REIT subsidiary of the trust provided services to such tenants.

"(C) REDETERMINED DEDUCTIONS.—The term 'redetermined deductions' means deductions (other than redetermined rents) of a taxable REIT subsidiary of a real estate investment trust if the amount of such deductions would (but for subparagraph (E)) be decreased on distribution, apportionment, or allocation under section 482 to clearly reflect income as between such subsidiary and such trust.

"(D) EXCESS INTEREST.—The term 'excess interest' means any deductions for interest payments by a taxable REIT subsidiary of a real estate investment trust to such trust to the extent that the interest payments are in excess of a rate that is commercially reasonable.

"(E) COORDINATION WITH SECTION 482.—The imposition of tax under subparagraph (A) shall be in lieu of any distribution, apportionment, or allocation under section 482.

"(F) REGULATORY AUTHORITY.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph. Until the Secretary prescribes such regulations, real estate investment trusts and their taxable REIT subsidiaries may base their allocations on any reasonable method.".

(b) AMOUNT SUBJECT TO TAX NOT REQUIRED TO BE DISTRIBUTED.—Subparagraph (E) of section 857(b)(2) (relating to real estate investment trust taxable income) is amended by striking "paragraph (5)" and inserting "paragraphs (5) and (7)".

SEC. 1116. EFFECTIVE DATE.

(a) IN GENERAL.—The amendments made by this part shall apply to taxable years beginning after December 31, 2000.

(b) TRANSITIONAL RULES RELATED TO SECTION 1111.—

(1) EXISTING ARRANGEMENTS.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, the amendment made by section 1111 shall not apply to a real estate investment trust with respect to—

(i) securities of a corporation held directly or indirectly by such trust on July 12, 1999,

(ii) securities of a corporation held by an entity on July 12, 1999, if such trust acquires control of such entity pursuant to a written binding contract in effect on such date and at all times thereafter before such acquisition,

(iii) securities received by such trust (or a successor) in exchange for, or with respect to, securities described in clause (i) or (ii) in a transaction in which gain or loss is not recognized, and

(iv) securities acquired directly or indirectly by such trust as part of a reorganization (as defined in section 368(a)(1) of the Internal Revenue Code of 1986) with respect to such trust if such securities are described in clause (i), (ii), or (iii) with respect to any other real estate investment trust.

(B) NEW TRADE OR BUSINESS OR SUBSTANTIAL NEW ASSETS.—Subparagraph (A) shall cease to apply to securities of a corporation as of the first day after July 12, 1999, on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than—

(i) pursuant to a binding contract in effect on such date and at all times thereafter before the acquisition of such asset,

(ii) in a transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Internal Revenue Code of 1986, or

(iii) in a reorganization (as so defined) with another corporation the securities of which are described in paragraph (1)(A) of this subsection.

(C) LIMITATION ON TRANSITION RULES.—Subparagraph (A) shall cease to apply to securities of a corporation held, acquired, or received, directly or indirectly, by a real estate investment trust as of the first day after July 12, 1999, on which such trust acquires any additional securities of such corporation other than—

(i) pursuant to a binding contract in effect on July 12, 1999, and at all times thereafter, or

(ii) in a reorganization (as so defined) with another corporation the securities of which are described in paragraph (1)(A) of this subsection.

(2) TAX-FREE CONVERSION.—If—

(A) at the time of an election for a corporation to become a taxable REIT subsidiary, the amendment made by section 1021 does not apply to such corporation by reason of paragraph (1), and

(B) such election first takes effect before January 1, 2004,

such election shall be treated as a reorganization qualifying under section 368(a)(1)(A) of such Code.

PART II—HEALTH CARE REITS

SEC. 1121. HEALTH CARE REITS.

(a) SPECIAL FORECLOSURE RULE FOR HEALTH CARE PROPERTIES.—Subsection (e) of section 856 (relating to special rules for foreclosure property) is amended by adding at the end the following new paragraph:

"(6) SPECIAL RULE FOR QUALIFIED HEALTH CARE PROPERTIES.—For purposes of this subsection—

"(A) ACQUISITION AT EXPIRATION OF LEASE.—The term 'foreclosure property' shall include any qualified health care property acquired by a real estate investment trust as the result of the termination of a lease of such property (other than a termination by reason of a default, or the imminence of a default, on the lease).

"(B) GRACE PERIOD.—In the case of a qualified health care property which is foreclosure property solely by reason of subparagraph (A), in lieu of applying paragraphs (2) and (3)—

"(i) the qualified health care property shall cease to be foreclosure property as of the close of the second taxable year after the taxable year in which such trust acquired such property, and

"(ii) if the real estate investment trust establishes to the satisfaction of the Secretary that an extension of the grace period in clause (i) is necessary to the orderly leasing or liquidation of the trust's interest in such qualified health care property, the Secretary may grant 1 or more extensions of the grace period for such qualified health care property.

Any such extension shall not extend the grace period beyond the close of the 6th year after the taxable year in which such trust acquired such qualified health care property.

"(C) INCOME FROM INDEPENDENT CONTRACTORS.—For purposes of applying paragraph (4)(C) with respect to qualified health care property which is foreclosure property by reason of subparagraph (A) or paragraph (1), income derived or received by the trust from an independent contractor shall be disregarded to the extent such income is attributable to—

"(i) any lease of property in effect on the date the real estate investment trust acquired the qualified health care property (without regard to its renewal after such date so long as such renewal is pursuant to the terms of such lease as in effect on such date), or

"(ii) any lease of property entered into after such date if—

"(I) on such date, a lease of such property from the trust was in effect, and

"(II) under the terms of the new lease, such trust receives a substantially similar or lesser benefit in comparison to the lease referred to in subclause (I).

"(D) QUALIFIED HEALTH CARE PROPERTY.—

"(i) IN GENERAL.—The term 'qualified health care property' means any real property (including interests therein), and any personal property incident to such real property, which—

"(I) is a health care facility, or

"(II) is necessary or incidental to the use of a health care facility.

"(ii) HEALTH CARE FACILITY.—For purposes of clause (i), the term 'health care facility' means a hospital, nursing facility, assisted living facility, congregate care facility, qualified continuing care facility (as defined in section 7872(g)(4)), or other licensed facility which extends medical or nursing or ancillary services to patients and which, immediately before the termination, expiration, default, or breach of the lease of or mortgage secured by such facility, was operated by a provider of such services which was eligible for participation in the medicare program under title XVIII of the Social Security Act with respect to such facility.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

PART III—CONFORMITY WITH REGULATED INVESTMENT COMPANY RULES

SEC. 1131. CONFORMITY WITH REGULATED INVESTMENT COMPANY RULES.

(a) DISTRIBUTION REQUIREMENT.—Clauses (i) and (ii) of section 857(a)(1)(A) (relating to requirements applicable to real estate investment trusts) are each amended by striking "95 percent (90 percent for taxable years beginning before January 1, 1980)" and inserting "90 percent".

(b) IMPOSITION OF TAX.—Clause (i) of section 857(b)(5)(A) (relating to imposition of tax in case of failure to meet certain requirements) is amended by striking "95 percent (90 percent in the case of taxable years beginning before January 1, 1980)" and inserting "90 percent".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

PART IV—CLARIFICATION OF EXCEPTION FROM IMPERMISSIBLE TENANT SERVICE INCOME

SEC. 1141. CLARIFICATION OF EXCEPTION FOR INDEPENDENT OPERATORS.

(a) IN GENERAL.—Paragraph (3) of section 856(d) (relating to independent contractor defined) is amended by adding at the end the following flush sentence:

"In the event that any class of stock of either the real estate investment trust or such person is regularly traded on an established securities market, only persons who own, directly or indirectly, more than 5 percent of such class of stock shall be taken into account as owning any of the stock of such class for purposes of applying the 35 percent limitation set forth in subparagraph (B) (but all of the outstanding stock of such class shall be considered outstanding in order to compute the denominator for purpose of determining the applicable percentage of ownership).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

PART V—MODIFICATION OF EARNINGS AND PROFITS RULES

SEC. 1151. MODIFICATION OF EARNINGS AND PROFITS RULES.

(a) RULES FOR DETERMINING WHETHER REGULATED INVESTMENT COMPANY HAS EARNINGS AND PROFITS FROM NON-RIC YEAR.—Subsection (c) of section 852 is amended by adding at the end the following new paragraph:

"(3) DISTRIBUTIONS TO MEET REQUIREMENTS OF SUBSECTION (a)(2)(B).—Any distribution which is made in order to comply with the requirements of subsection (a)(2)(B)—

"(A) shall be treated for purposes of this subsection and subsection (a)(2)(B) as made from the earliest earnings and profits accumulated in any taxable year to which the provisions of this part did not apply rather than the most recently accumulated earnings and profits, and

"(B) to the extent treated under subparagraph (A) as made from accumulated earnings and profits, shall not be treated as a distribution for purposes of subsection (b)(2)(D) and section 855.".

(b) CLARIFICATION OF APPLICATION OF REIT SPILLOVER DIVIDEND RULES TO DISTRIBUTIONS TO MEET QUALIFICATION REQUIREMENT.—Subparagraph (B) of section 857(d)(3) is amended by inserting before the period "and section 858".

(c) APPLICATION OF DEFICIENCY DIVIDEND PROCEDURES.—Paragraph (1) of section 852(e) is amended by adding at the end the following new sentence: "If the determination under subparagraph (A) is solely as a result of the failure to meet the requirements of subsection (a)(2), the preceding sentence shall also apply for purposes of applying subsection (a)(2) to the non-RIC year.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

Subtitle C—Modification of At-Risk Rules for Publicly Traded Nonrecourse Debt

SEC. 1161. TREATMENT UNDER AT-RISK RULES OF PUBLICLY TRADED NONRECOURSE DEBT.

(a) IN GENERAL.—Subparagraph (A) of section 465(b)(6) (relating to qualified nonrecourse financing treated as amount at risk) is amended by striking "share of" and all that follows and inserting "share of—

"(i) any qualified nonrecourse financing which is secured by real property used in such activity, and

"(ii) any other financing which—

"(I) would (but for subparagraph (B)(ii)) be qualified nonrecourse financing,

"(II) is qualified publicly traded debt, and

"(III) is not borrowed by the taxpayer from a person described in subclause (I), (II), or (III) of section 49(a)(1)(D)(iv).".

(b) QUALIFIED PUBLICLY TRADED DEBT.—Paragraph (6) of section 465(b) is amended by adding at the end the following new subparagraph:

"(F) QUALIFIED PUBLICLY TRADED DEBT.—For purposes of subparagraph (A), the term 'qualified publicly traded debt' means any debt instrument which is readily tradable on an established securities market. Such term shall not include any debt instrument which has a yield to maturity which equals or exceeds the limitation in section 163(i)(1)(B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to debt instruments issued after December 31, 1999.

Subtitle D—Treatment of Certain Contributions to Capital of Retailers

SEC. 1171. EXCLUSION FROM GROSS INCOME FOR CERTAIN CONTRIBUTIONS TO THE CAPITAL OF CERTAIN RETAILERS.

(a) IN GENERAL.—Section 118 (relating to contributions to the capital of a corporation) is amended by redesignating subsections (d) and (e) as subsections (e) and (f), respectively, and by inserting after subsection (c) the following new subsection:

"(d) SAFE HARBOR FOR CONTRIBUTIONS TO CERTAIN RETAILERS.—

"(1) GENERAL RULE.—For purposes of this section, the term 'contribution to the capital of the taxpayer' includes any amount of money or other property received by the taxpayer if—

"(A) the taxpayer has entered into an agreement to operate (or cause to be operated) a qualified retail business at a particular location for a period of at least 15 years,

"(B)(i) immediately after the receipt of such money or other property, the taxpayer owns the land and the structure to be used by the taxpayer in carrying on a qualified retail business at such location, or

"(ii) the taxpayer uses such amount to acquire ownership of at least such land and structure,

"(C) such amount meets the requirements of the expenditure rule of paragraph (2), and

"(D) the contributor of such amount does not hold a beneficial interest in any property located on the premises of such qualified retail business other than de minimis amounts of property associated with the operation of property adjacent to such premises.

"(2) EXPENDITURE RULE.—An amount meets the requirements of this paragraph if—

"(A) an amount equal to such amount is expended for the acquisition of land or for acquisition or construction of other property described in section 1231(b)—

"(i) which was the purpose motivating the contribution, and

"(ii) which is used predominantly in a qualified retail business at the location referred to in paragraph (1)(A),

"(B) the expenditure referred to in subparagraph (A) occurs before the end of the second taxable year after the year in which such amount was received, and

"(C) accurate records are kept of the amounts contributed and expenditures made on the basis of the project for which the contribution was made and on the basis of the year of the contribution expenditure.

"(3) DEFINITION OF QUALIFIED RETAIL BUSINESS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'qualified retail business' means a trade or business of selling tangible personal property to the general public if the premises on which such trade or business is conducted is in close proximity to property that the contributor of the amount referred to in paragraph (1) is developing or operating for profit (or, in the case of a contributor which is a governmental entity, is attempting to revitalize).

"(B) SERVICES.—A trade or business shall not fail to be treated as a qualified retail business by reason of sales of services if such sales are incident to the sale of tangible personal property or if the services are de minimis in amount.

"(4) SPECIAL RULES.—

"(A) LEASES.—For purposes of paragraph (1)(B)(i), property shall be treated as owned by the taxpayer if the taxpayer is the lessee of such property under a lease having a term of at least 30 years and on which only nominal rent is required.

"(B) CONTROLLED GROUPS.—For purposes of this subsection, all persons treated as a single employer under subsection (a) or (b) of section 52 shall be treated as 1 person.

"(5) DISALLOWANCE OF DEDUCTIONS AND CREDITS; ADJUSTED BASIS.—Notwithstanding any other provision of this

subtitle, no deduction or credit shall be allowed for, or by reason of, any amount received by the taxpayer which constitutes a contribution to capital to which this subsection applies. The adjusted basis of any property acquired with the contributions to which this subsection applies shall be reduced by the amount of the contributions to which this subsection applies.

"(6) REGULATIONS.—The Secretary shall prescribe such regulations are appropriate to prevent the abuse of the purposes of the subsection, including regulations which allocate income and deductions (or adjust the amount excludable under this subsection) in cases in which—

"(A) payments in excess of fair market value are paid to the contributor by the taxpayer, or

"(B) the contributor and the taxpayer are related parties.".

(b) CONFORMING AMENDMENT.—Subsection (e) of section 118 (as redesignated by subsection (a)) is amended by adding at the end the following flush sentence:

"Rules similar to the rules of the preceding sentence shall apply to any amount treated as a contribution to the capital of the taxpayer under subsection (d).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts received after December 31, 1999.

Subtitle E—Private Activity Bond Volume Cap

SEC. 1181. ACCELERATION OF PHASE-IN OF INCREASE IN VOLUME CAP ON PRIVATE ACTIVITY BONDS.

(a) IN GENERAL.—The table contained in section 146(d)(2) (relating to per capita limit; aggregate limit) is amended to read as follows:

Calendar Year	*Per Capita Limit*	*Aggregate Limit*
2000	*$55.00*	*165,000,000*
2001	*60.00*	*180,000,000*
2002	*65.00*	*195,000,000*
2003	*70.00*	*210,000,000*
2004 and thereafter	*75.00*	*225,000,000."*

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to calendar years beginning after 1999.

Subtitle F—Deduction for Renovating Historic Homes

SEC. 1191. DEDUCTION FOR RENOVATING HISTORIC HOMES.

(a) IN GENERAL.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 223 as section 224 and by inserting after section 222 the following new section:

"SEC. 223. HISTORIC HOMEOWNERSHIP REHABILITATION DEDUCTION.

"(a) GENERAL RULE.—In the case of an individual, there shall be allowed as a deduction an amount equal to 50 percent of the

qualified rehabilitation expenditures made by the taxpayer with respect to a qualified historic home.

"(b) DOLLAR LIMITATION.—The deduction allowed by subsection (a) with respect to any residence of a taxpayer shall not exceed $50,000 ($25,000 in the case of a married individual filing a separate return).

"(c) QUALIFIED REHABILITATION EXPENDITURE.—For purposes of this section—

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

"(A) in connection with the certified rehabilitation of a qualified historic home, and

"(B) for property for which depreciation would be allowable under section 168 if the qualified historic home were used in a trade or business.

"(2) CERTAIN EXPENDITURES NOT INCLUDED.—

"(A) EXTERIOR.—Such term shall not include any expenditure in connection with the rehabilitation of a building unless at least 5 percent of the total expenditures made in the rehabilitation process are allocable to the rehabilitation of the exterior of such building.

"(B) OTHER RULES TO APPLY.—Rules similar to the rules of clauses (ii) and (iii) of section 47(c)(2)(B) shall apply.

"(3) MIXED USE OR MULTIFAMILY BUILDING.—If only a portion of a building is used as the principal residence of the taxpayer, only qualified rehabilitation expenditures which are properly allocable to such portion shall be taken into account under this section.

"(d) CERTIFIED REHABILITATION.—For purposes of this section:

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the term 'certified rehabilitation' has the meaning given such term by section 47(c)(2)(C).

"(2) FACTORS TO BE CONSIDERED IN THE CASE OF TARGETED AREA RESIDENCES, ETC.—

"(A) IN GENERAL.—For purposes of applying section 47(c)(2)(C) under this section with respect to the rehabilitation of a building to which this paragraph applies, consideration shall be given to—

"(i) the feasibility of preserving existing architectural and design elements of the interior of such building,

"(ii) the risk of further deterioration or demolition of such building in the event that certification is denied because of the failure to preserve such interior elements, and

"(iii) the effects of such deterioration or demolition on neighboring historic properties.

"(B) BUILDINGS TO WHICH THIS PARAGRAPH APPLIES.—This paragraph shall apply with respect to any building—

"(i) any part of which is a targeted area residence within the meaning of section 143(j)(1), or

"(ii) which is located within an enterprise community or empowerment zone as designated under section 1391,

but shall not apply with respect to any building which is listed in the National Register.

"(3) APPROVED STATE PROGRAM.—The term 'certified rehabilitation' includes a certification made by—

"(A) a State Historic Preservation Officer who administers a State Historic Preservation Program approved by the Secretary of the Interior pursuant to section 101(b)(1) of the National Historic Preservation Act, as in effect on July 21, 1999, or

"(B) a local government, certified pursuant to section 101(c)(1) of the National Historic Preservation Act, as in effect on July 21, 1999, and authorized by a State Historic Preservation Officer, or the Secretary of the Interior where there is no approved State program),

subject to such terms and conditions as may be specified by the Secretary of the Interior for the rehabilitation of buildings within the jurisdiction of such officer (or local government) for purposes of this section.

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

"(1) QUALIFIED HISTORIC HOME.—The term 'qualified historic home' means a certified historic structure—

"(A) which has been substantially rehabilitated, and

"(B) which (or any portion of which)—

"(i) is owned by the taxpayer, and

"(ii) is used (or will, within a reasonable period, be used) by such taxpayer as his principal residence.

"(2) SUBSTANTIALLY REHABILITATED.—The term 'substantially rehabilitated' has the meaning given such term by section 47(c)(1)(C); except that, in the case of any building described in subsection (d)(2), clause (i)(I) of section 47(c)(1)(C) shall not apply.

"(3) PRINCIPAL RESIDENCE.—The term 'principal residence' has the same meaning as when used in section 121.

"(4) CERTIFIED HISTORIC STRUCTURE.—

"(A) IN GENERAL.—The term 'certified historic structure' means any building (and its structural components) which—

"(i) is listed in the National Register, or

"(ii) is located in a registered historic district (as defined in section 47(c)(3)(B)) within which only qualified census tracts (or portions thereof) are located, and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

"(B) CERTAIN STRUCTURES INCLUDED.—Such term includes any building (and its structural components) which is designated as being of historic significance under a statute of a State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the

purpose of preserving and rehabilitating buildings of historic significance.

"(C) QUALIFIED CENSUS TRACTS.—For purposes of subparagraph (A)(ii)—

"(i) IN GENERAL.—The term 'qualified census tract' means a census tract in which the median family income is less than twice the statewide median family income.

"(ii) DATA USED.—The determination under clause (i) shall be made on the basis of the most recent decennial census for which data are available.

"(5) REHABILITATION NOT COMPLETE BEFORE CERTIFICATION.—A rehabilitation shall not be treated as complete before the date of the certification referred to in subsection (d).

"(6) LESSEES.—A taxpayer who leases his principal residence shall, for purposes of this section, be treated as the owner thereof if the remaining term of the lease (as of the date determined under regulations prescribed by the Secretary) is not less than such minimum period as the regulations require.

"(7) TENANT-STOCKHOLDER IN COOPERATIVE HOUSING CORPORATION.—If the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as defined in such section), such stockholder shall be treated as owning the house or apartment which the taxpayer is entitled to occupy as such stockholder.

"(8) ALLOCATION OF EXPENDITURES RELATING TO EXTERIOR OF BUILDING CONTAINING COOPERATIVE OR CONDOMINIUM UNITS.—The percentage of the total expenditures made in the rehabilitation of a building containing cooperative or condominium residential units allocated to the rehabilitation of the exterior of the building shall be attributed proportionately to each cooperative or condominium residential unit in such building for which a deduction under this section is claimed.

"(f) WHEN EXPENDITURES TAKEN INTO ACCOUNT.—Qualified rehabilitation expenditures shall be treated for purposes of this section as made on the date the rehabilitation is completed.

"(g) RECAPTURE.—

"(1) IN GENERAL.—If, before the end of the 5-year period beginning on the date on which the rehabilitation of the building is completed—

"(A) the taxpayer disposes of such taxpayer's interest in such building, or

"(B) such building ceases to be used as the principal residence of the taxpayer,

the taxpayer's gross income for the taxable year in which such disposition or cessation occurs shall be increased by the recapture percentage of the deduction allowed under this section for all prior taxable years with respect to such rehabilitation.

"(2) RECAPTURE PERCENTAGE.—For purposes of paragraph (1), the recapture percentage shall be determined in accordance with the following table:

"If the disposition or cessation occurs within—	*The recapture percentage is—*
(i) One full year after the taxpayer becomes entitled to the deduction	*100*
(ii) One full year after the close of the period described in clause (i)	*805*
(iii) One full year after the close of the period described in clause (ii)	*60*
(iv) One full year after the close of the period described in clause (iii)	*40*
(v) One full year after the close of the period described in clause (iv)	*20.".*

"(h) BASIS ADJUSTMENTS.—For purposes of this subtitle, if a deduction is allowed under this section for any expenditure with respect to any property, the increase in the basis of such property which would (but for this subsection) result from such expenditure shall be reduced by the amount of the deduction so allowed.

"(i) DENIAL OF DOUBLE BENEFIT.—No deduction shall be allowed under this section for any amount for which credit is allowed under section 47.

"(j) REGULATIONS.—The Secretary shall prescribe such regulations as may be appropriate to carry out the purposes of this section, including regulations where less than all of a building is used as a principal residence and where more than 1 taxpayer use the same dwelling unit as their principal residence.".

(b) CONFORMING AMENDMENTS.—

(1) Clause (i) of section 56(b)(1)(A) is amended by inserting before the comma "other than the deduction under section 223 (relating to historic homeownership rehabilitation deduction)".

(2) Subsection (a) of section 1016 is amended by striking "and" at the end of paragraph (27), by striking the period at the end of paragraph (28) and inserting ", and", and by adding at the end the following new item:

"(29) to the extent provided in section 223(h).".

(c) CLERICAL AMENDMENT.—The table of sections for part VII of subchapter B of chapter 1 is amended by striking the item relating to section 223 and inserting the following new items:

"Sec. 223. Historic homeownership rehabilitation deduction.
"Sec. 224. Cross reference."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to expenses paid or incurred in taxable years beginning after December 31, 1999.

TITLE XII—PROVISIONS RELATING TO PENSIONS

Subtitle A—Expanding Coverage

SEC. 1201. INCREASE IN BENEFIT AND CONTRIBUTION LIMITS.

(a) DEFINED BENEFIT PLANS.—

(1) DOLLAR LIMIT.—

(A) Subparagraph (A) of section 415(b)(1) (relating to limitation for defined benefit plans) is amended by striking "$90,000" and inserting "$160,000".

(B) Subparagraphs (C) and (D) of section 415(b)(2) are each amended by striking "$90,000" each place it appears in the headings and the text and inserting "$160,000".

(C) Paragraph (7) of section 415(b) (relating to benefits under certain collectively bargained plans) is amended by striking "the greater of $68,212 or one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$90,000'" and inserting "one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$160,000'".

(2) LIMIT REDUCED WHEN BENEFIT BEGINS BEFORE AGE 62.—Subparagraph (C) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 62".

(3) LIMIT INCREASED WHEN BENEFIT BEGINS AFTER AGE 65.—Subparagraph (D) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 65".

(4) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) by striking "$90,000" in paragraph (1)(A) and inserting "$160,000", and

(B) in paragraph (3)(A)—

(i) by striking "$90,000" in the heading and inserting "$160,000", and

(ii) by striking "October 1, 1986" and inserting "July 1, 2000".

(5) CONFORMING AMENDMENT.—Section 415(b)(2) is amended by striking subparagraph (F).

(b) DEFINED CONTRIBUTION PLANS.—

(1) DOLLAR LIMIT.—Subparagraph (A) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "$30,000" and inserting "$40,000".

(2) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) by striking "$30,000" in paragraph (1)(C) and inserting "$40,000", and

(B) in paragraph (3)(D)—

(i) by striking "$30,000" in the heading and inserting "$40,000", and

(ii) by striking "October 1, 1993" and inserting "July 1, 2000".

(c) QUALIFIED TRUSTS.—

(1) COMPENSATION LIMIT.—Sections 401(a)(17), 404(l), 408(k), and 505(b)(7) are each amended by striking "$150,000" each place it appears and inserting "$200,000".

(2) BASE PERIOD AND ROUNDING OF COST-OF-LIVING ADJUSTMENT.—Subparagraph (B) of section 401(a)(17) is amended—

(A) by striking "October 1, 1993" and inserting "July 1, 2000", and

(B) by striking "$10,000" both places it appears and inserting "$5,000".

(d) ELECTIVE DEFERRALS.—

(1) IN GENERAL.—Paragraph (1) of section 402(g) (relating to limitation on exclusion for elective deferrals) is amended to read as follows:

"(1) IN GENERAL.—

"(A) LIMITATION.—Notwithstanding subsections (e)(3) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount.

"(B) APPLICABLE DOLLAR AMOUNT.—For purposes of subparagraph (A), the applicable dollar amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in calendar year:	***The applicable dollar amount:***
2001	*$11,000*
2002	*$12,000*
2003	*$13,000*
2004	*$14,000*
2005 or thereafter	*$15,000."*

(2) COST-OF-LIVING ADJUSTMENT.—Paragraph (5) of section 402(g) is amended to read as follows:

"(5) COST-OF-LIVING ADJUSTMENT.—In the case of taxable years beginning after December 31, 2005, the Secretary shall adjust the $15,000 amount under paragraph (1)(B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2004, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Section 402(g) (relating to limitation on exclusion for elective deferrals), as amended by paragraphs (1) and (2), is further amended by striking paragraph (4) and redesignating paragraphs (5), (6), (7), (8), and (9) as paragraphs (4), (5), (6), (7), and (8), respectively.

(B) Paragraph (2) of section 457(c) is amended by striking "402(g)(8)(A)(iii)" and inserting "402(g)(7)(A)(iii)".

(C) Clause (iii) of section 501(c)(18)(D) is amended by striking "(other than paragraph (4) thereof)".

(e) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations) is amended—

(A) in subsections (b)(2)(A) and (c)(1) by striking "$7,500" each place it appears and inserting "the applicable dollar amount", and

(B) in subsection (b)(3)(A) by striking "$15,000" and inserting "twice the dollar amount in effect under subsection (b)(2)(A)".

(2) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—Paragraph (15) of section 457(e) is amended to read as follows:

"(15) APPLICABLE DOLLAR AMOUNT.—

"(A) IN GENERAL.—The applicable dollar amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in calendar year:	*The applicable dollar amount:*
2001	*$11,000*
2002	*$12,000*
2003	*$13,000*
2004	*$14,000*
2005 or thereafter	*$15,000.*

"(B) COST-OF-LIVING ADJUSTMENTS.—In the case of taxable years beginning after December 31, 2005, the Secretary shall adjust the $15,000 amount specified in the table in subparagraph (A) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2004, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(f) SIMPLE RETIREMENT ACCOUNTS.—

(1) LIMITATION.—Clause (ii) of section 408(p)(2)(A) (relating to general rule for qualified salary reduction arrangement) is amended by striking "$6,000" and inserting "the applicable dollar amount".

(2) APPLICABLE DOLLAR AMOUNT.—Subparagraph (E) of 408(p)(2) is amended to read as follows:

"(E) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(ii), the applicable dollar amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in calendar year:	*The applicable dollar amount:*
2001	*$7,000*
2002	*$8,000*
2003	*$9,000*
2004 or thereafter	*$10,000.*

"(ii) COST-OF-LIVING ADJUSTMENT.—In the case of a year beginning after December 31, 2004, the Secretary shall adjust the $10,000 amount under clause (i) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter beginning July 1, 2003, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Clause (I) of section 401(k)(11)(B)(i) is amended by striking "$6,000" and inserting "the amount in effect under section 408(p)(2)(A)(ii)".

(B) Section 401(k)(11) is amended by striking subparagraph (E).

(g) ROUNDING RULE RELATING TO DEFINED BENEFIT PLANS AND DEFINED CONTRIBUTION PLANS.—Paragraph (4) of section 415(d) is amended to read as follows:

"(4) ROUNDING.—

"(A) $160,000 AMOUNT.—Any increase under subparagraph (A) of paragraph (1) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

"(B) $40,000 AMOUNT.—Any increase under subparagraph (C) of paragraph (1) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.".

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1202. PLAN LOANS FOR SUBCHAPTER S OWNERS, PARTNERS, AND SOLE PROPRIETORS.

(a) AMENDMENT TO 1986 CODE.—Subparagraph (B) of section 4975(f)(6) (relating to exemptions not to apply to certain transactions) is amended by adding at the end the following new clause:

"(iii) LOAN EXCEPTION.—For purposes of subparagraph (A)(i), the term 'owner-employee' shall only include a person described in subclause (II) or (III) of clause (i).".

(b) AMENDMENT TO ERISA.—Section 408(d)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(d)(2)) is amended by adding at the end the following new subparagraph:

"(C) For purposes of paragraph (1)(A), the term 'owner-employee' shall only include a person described in clause (ii) or (iii) of subparagraph (A).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to loans made after December 31, 2000.

SEC. 1203. MODIFICATION OF TOP-HEAVY RULES.

(a) SIMPLIFICATION OF DEFINITION OF KEY EMPLOYEE.—

(1) IN GENERAL.—Section 416(i)(1)(A) (defining key employee) is amended—

(A) by striking "or any of the 4 preceding plan years" in the matter preceding clause (i),

(B) by striking clause (i) and inserting the following:

"(i) an officer of the employer having an annual compensation greater than $150,000,",

(C) by striking clause (ii) and redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively, and

(D) by striking the second sentence in the matter following clause (iii), as redesignated by subparagraph (C).

(2) CONFORMING AMENDMENT.—Section 416(i)(1)(B)(iii) is amended by striking "and subparagraph (A)(ii)".

(b) MATCHING CONTRIBUTIONS TAKEN INTO ACCOUNT FOR MINIMUM CONTRIBUTION REQUIREMENTS.—Section 416(c)(2)(A) (relating to defined contribution plans) is amended by adding at the end the following: "Employer matching contributions (as defined in section 401(m)(4)(A)) shall be taken into account for purposes of this subparagraph.".

(c) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Paragraph (3) of section 416(g) is amended to read as follows:

"(3) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

"(A) IN GENERAL.—For purposes of determining—

"(i) the present value of the cumulative accrued benefit for any employee, or

"(ii) the amount of the account of any employee,

such present value or amount shall be increased by the aggregate distributions made with respect to such employee under the plan during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which if it had not been terminated would have been required to be included in an aggregation group.

"(B) 5-YEAR PERIOD IN CASE OF IN-SERVICE DISTRIBUTION.—In the case of any distribution made for a reason other than separation from service, death, or disability, subparagraph (A) shall be applied by substituting '5-year period' for '1-year period'.".

(2) BENEFITS NOT TAKEN INTO ACCOUNT.—Subparagraph (E) of section 416(g)(4) is amended—

(A) by striking "LAST 5 YEARS" in the heading and inserting "LAST YEAR BEFORE DETERMINATION DATE", and

(B) by striking "5-year period" and inserting "1-year period".

(d) DEFINITION OF TOP-HEAVY PLANS.—Paragraph (4) of section 416(g) (relating to other special rules for top-heavy plans) is amended by adding at the end the following new subparagraph:

"(H) CASH OR DEFERRED ARRANGEMENTS USING ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—The term 'top-heavy plan' shall not include a plan which consists solely of—

"(i) a cash or deferred arrangement which meets the requirements of section 401(k)(12), and

"(ii) matching contributions with respect to which the requirements of section 401(m)(11) are met.

If, but for this subparagraph, a plan would be treated as a top-heavy plan because it is a member of an aggregation group which is a top-heavy group, contributions under the plan may be taken into account in determining whether any other plan in the group meets the requirements of subsection (c)(2).".

(e) FROZEN PLAN EXEMPT FROM MINIMUM BENEFIT REQUIREMENT.—Subparagraph (C) of section 416(c)(1) (relating to defined benefit plans) is amended—

(A) by striking "clause (ii)" in clause (i) and inserting "clause (ii) or (iii)", and

(B) by adding at the end the following:

"(iii) EXCEPTION FOR FROZEN PLAN.—For purposes of determining an employee's years of service with the employer, any service with the employer shall be disregarded to the extent that such service occurs during a plan year when the plan benefits (within the meaning of section 410(b)) no employee or former employee.".

(f) ELIMINATION OF FAMILY ATTRIBUTION.—Section 416(i)(1)(B) (defining 5-percent owner) is amended by adding at the end the following new clause:

> *"(iv) FAMILY ATTRIBUTION DISREGARDED.—Solely for purposes of applying this paragraph (and not for purposes of any provision of this title which incorporates by reference the definition of a key employee or 5-percent owner under this paragraph), section 318 shall be applied without regard to subsection (a)(1) thereof in determining whether any person is a 5-percent owner.".*

(g) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1204. ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.

(a) IN GENERAL.—Section 404 (relating to deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan) is amended by adding at the end the following new subsection:

"(n) ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.—Elective deferrals (as defined in section 402(g)(3)) shall not be subject to any limitation contained in paragraph (3), (7), or (9) of subsection (a), and such elective deferrals shall not be taken into account in applying any such limitation to any other contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

SEC. 1205. REPEAL OF COORDINATION REQUIREMENTS FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Subsection (c) of section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations), as amended by section 1201, is amended to read as follows:

"(c) LIMITATION.—The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the amount in effect under subsection (b)(2)(A) (as modified by any adjustment provided under subsection (b)(3)).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 2000.

SEC. 1206. ELIMINATION OF USER FEE FOR REQUESTS TO IRS REGARDING PENSION PLANS.

(a) ELIMINATION OF CERTAIN USER FEES.—The Secretary of the Treasury or the Secretary's delegate shall not require payment of user fees under the program established under section 7527 of the Internal Revenue Code of 1986 for requests to the Internal Revenue Service for determination letters with respect to the qualified status of a pension benefit plan maintained solely by one or more eligible employers or any trust which is part of the plan. The preceding sentence shall not apply to any request—

> *(1) made after the 5th plan year the pension benefit plan is in existence, or*

(2) made by the sponsor of any prototype or similar plan which the sponsor intends to market to participating employers.

(b) PENSION BENEFIT PLAN.—For purposes of this section, the term "pension benefit plan" means a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan.

(c) ELIGIBLE EMPLOYER.—For purposes of this section, the term "eligible employer" has the same meaning given such term in section 408(p)(2)(C)(i)(I) of the Internal Revenue Code of 1986. The determination of whether an employer is an eligible employer under this section shall be made as of the date of the request described in subsection (a).

(d) EFFECTIVE DATE.—The provisions of this section shall apply with respect to requests made after December 31, 2000.

SEC. 1207. DEDUCTION LIMITS.

(a) IN GENERAL.—Section 404(a) (relating to general rule) is amended by adding at the end the following:

"(12) DEFINITION OF COMPENSATION.—For purposes of paragraphs (3), (7), (8), and (9), the term 'compensation' shall include amounts treated as participant's compensation under subparagraph (C) or (D) of section 415(c)(3).".

(b) CONFORMING AMENDMENT.—Subparagraph (B) of section 404(a)(3) is amended by striking the last sentence thereof.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1208. OPTION TO TREAT ELECTIVE DEFERRALS AS AFTER-TAX CONTRIBUTIONS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to deferred compensation, etc.) is amended by inserting after section 402 the following new section:

"SEC. 402A. OPTIONAL TREATMENT OF ELECTIVE DEFERRALS AS PLUS CONTRIBUTIONS.

"(a) GENERAL RULE.—If an applicable retirement plan includes a qualified plus contribution program—

"(1) any designated plus contribution made by an employee pursuant to the program shall be treated as an elective deferral for purposes of this chapter, except that such contribution shall not be excludable from gross income, and

"(2) such plan (and any arrangement which is part of such plan) shall not be treated as failing to meet any requirement of this chapter solely by reason of including such program.

"(b) QUALIFIED PLUS CONTRIBUTION PROGRAM.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified plus contribution program' means a program under which an employee may elect to make designated plus contributions in lieu of all or a portion of elective deferrals the employee is otherwise eligible to make under the applicable retirement plan.

"(2) SEPARATE ACCOUNTING REQUIRED.—A program shall not be treated as a qualified plus contribution program unless the applicable retirement plan—

"(A) establishes separate accounts ('designated plus accounts') for the designated plus contributions of each em-

ployee and any earnings properly allocable to the contributions, and

"(B) maintains separate recordkeeping with respect to each account.

"(c) DEFINITIONS AND RULES RELATING TO DESIGNATED PLUS CONTRIBUTIONS.—For purposes of this section—

"(1) DESIGNATED PLUS CONTRIBUTION.—The term 'designated plus contribution' means any elective deferral which—

"(A) is excludable from gross income of an employee without regard to this section, and

"(B) the employee designates (at such time and in such manner as the Secretary may prescribe) as not being so excludable.

"(2) DESIGNATION LIMITS.—The amount of elective deferrals which an employee may designate under paragraph (1) shall not exceed the excess (if any) of—

"(A) the maximum amount of elective deferrals excludable from gross income of the employee for the taxable year (without regard to this section), over

"(B) the aggregate amount of elective deferrals of the employee for the taxable year which the employee does not designate under paragraph (1).

"(3) ROLLOVER CONTRIBUTIONS.—

"(A) IN GENERAL.—A rollover contribution of any payment or distribution from a designated plus account which is otherwise allowable under this chapter may be made only if the contribution is to—

"(i) another designated plus account of the individual from whose account the payment or distribution was made, or

"(ii) a Roth IRA of such individual.

"(B) COORDINATION WITH LIMIT.—Any rollover contribution to a designated plus account under subparagraph (A) shall not be taken into account for purposes of paragraph (1).

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

"(1) EXCLUSION.—Any qualified distribution from a designated plus account shall not be includible in gross income.

"(2) QUALIFIED DISTRIBUTION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified distribution' has the meaning given such term by section 408A(d)(2)(A) (without regard to clause (iv) thereof).

"(B) DISTRIBUTIONS WITHIN NONEXCLUSION PERIOD.—A payment or distribution from a designated plus account shall not be treated as a qualified distribution if such payment or distribution is made within the 5-taxable-year period beginning with the earlier of—

"(i) the 1st taxable year for which the individual made a designated plus contribution to any designated plus account established for such individual under the same applicable retirement plan, or

"(ii) if a rollover contribution was made to such designated plus account from a designated plus ac-

count previously established for such individual under another applicable retirement plan, the 1st taxable year for which the individual made a designated plus contribution to such previously established account.

"(C) DISTRIBUTIONS OF EXCESS DEFERRALS AND EARNINGS.—The term 'qualified distribution' shall not include any distribution of any excess deferral under section 402(g)(2) and any income on the excess deferral.

"(3) AGGREGATION RULES.—Section 72 shall be applied separately with respect to distributions and payments from a designated plus account and other distributions and payments from the plan.

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

"(1) APPLICABLE RETIREMENT PLAN.—The term 'applicable retirement plan' means—

"(A) an employees' trust described in section 401(a) which is exempt from tax under section 501(a), and

"(B) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

"(2) ELECTIVE DEFERRAL.—The term 'elective deferral' means any elective deferral described in subparagraph (A) or (C) of section 402(g)(3).".

(b) EXCESS DEFERRALS.—Section 402(g) (relating to limitation on exclusion for elective deferrals) is amended—

(1) by adding at the end of paragraph (1) the following new sentence: "The preceding sentence shall not apply to so much of such excess as does not exceed the designated plus contributions of the individual for the taxable year.", and

(2) by inserting "(or would be included but for the last sentence thereof)" after "paragraph (1)" in paragraph (2)(A).

(c) ROLLOVERS.—Subparagraph (B) of section 402(c)(8) is amended by adding at the end the following:

"If any portion of an eligible rollover distribution is attributable to payments or distributions from a designated plus account (as defined in section 402A), an eligible retirement plan with respect to such portion shall include only another designated plus account and a Roth IRA.".

(d) REPORTING REQUIREMENTS.—

(1) W–2 INFORMATION.—Section 6051(a)(8) is amended by inserting ", including the amount of designated plus contributions (as defined in section 402A)" before the comma at the end.

(2) INFORMATION.—Section 6047 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) DESIGNATED PLUS CONTRIBUTIONS.—The Secretary shall require the plan administrator of each applicable retirement plan (as defined in section 402A) to make such returns and reports regarding designated plus contributions (as so defined) to the Secretary, participants and beneficiaries of the plan, and such other persons as the Secretary may prescribe.".

(e) CONFORMING AMENDMENTS.—

(1) Section 408A(e) is amended by adding after the first sentence the following new sentence: "Such term includes a rollover contribution described in section 402A(c)(3)(A).".

(2) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 402 the following new item:

"Sec. 402A. Optional treatment of elective deferrals as plus contributions.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1209. REDUCED PBGC PREMIUM FOR NEW PLANS OF SMALL EMPLOYERS.

(a) IN GENERAL.—Subparagraph (A) of section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)(3)(A)) is amended—

(1) in clause (i), by inserting "other than a new single-employer plan (as defined in subparagraph (F)) maintained by a small employer (as so defined)," after "single-employer plan,",

(2) in clause (iii), by striking the period at the end and inserting ", and", and

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

"(iv) in the case of a new single-employer plan (as defined in subparagraph (F)) maintained by a small employer (as so defined) for the plan year, $5 for each individual who is a participant in such plan during the plan year.".

(b) DEFINITION OF NEW SINGLE-EMPLOYER PLAN.—Section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)(3)) is amended by adding at the end the following new subparagraph:

"(F)(i) For purposes of this paragraph, a single-employer plan maintained by a contributing sponsor shall be treated as a new single-employer plan for each of its first 5 plan years if, during the 36-month period ending on the date of the adoption of such plan, the sponsor or any member of such sponsor's controlled group (or any predecessor of either) had not established or maintained a plan to which this title applies with respect to which benefits were accrued for substantially the same employees as are in the new single-employer plan.

"(ii)(I) For purposes of this paragraph, the term 'small employer' means an employer which on the first day of any plan year has, in aggregation with all members of the controlled group of such employer, 100 or fewer employees.

"(II) In the case of a plan maintained by 2 or more contributing sponsors that are not part of the same controlled group, the employees of all contributing sponsors and controlled groups of such sponsors shall be aggregated for purposes of determining whether any contributing sponsor is a small employer.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plans established after December 31, 2000.

SEC. 1210. REDUCTION OF ADDITIONAL PBGC PREMIUM FOR NEW AND SMALL PLANS.

(a) NEW PLANS.—Subparagraph (E) of section 4006(a)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C.

1306(a)(3)(E)) is amended by adding at the end the following new clause:

"(v) In the case of a new defined benefit plan, the amount determined under clause (ii) for any plan year shall be an amount equal to the product of the amount determined under clause (ii) and the applicable percentage. For purposes of this clause, the term 'applicable percentage' means—

"(I) 0 percent, for the first plan year.

"(II) 20 percent, for the second plan year.

"(III) 40 percent, for the third plan year.

"(IV) 60 percent, for the fourth plan year.

"(V) 80 percent, for the fifth plan year.

For purposes of this clause, a defined benefit plan (as defined in section 3(35)) maintained by a contributing sponsor shall be treated as a new defined benefit plan for its first 5 plan years if, during the 36-month period ending on the date of the adoption of the plan, the sponsor and each member of any controlled group including the sponsor (or any predecessor of either) did not establish or maintain a plan to which this title applies with respect to which benefits were accrued for substantially the same employees as are in the new plan.".

(b) SMALL PLANS.—Paragraph (3) of section 4006(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1306(a)) is amended—

(1) by striking "The" in subparagraph (E)(i) and inserting "Except as provided in subparagraph (G), the", and

(2) by inserting after subparagraph (F) the following new subparagraph:

"(G)(i) In the case of an employer who has 25 or fewer employees on the first day of the plan year, the additional premium determined under subparagraph (E) for each participant shall not exceed $5 multiplied by the number of participants in the plan as of the close of the preceding plan year.

"(ii) For purposes of clause (i), whether an employer has 25 or fewer employees on the first day of the plan year is determined taking into consideration all of the employees of all members of the contributing sponsor's controlled group. In the case of a plan maintained by 2 or more contributing sponsors, the employees of all contributing sponsors and their controlled groups shall be aggregated for purposes of determining whether 25-or-fewer-employees limitation has been satisfied.".

(c) EFFECTIVE DATES.—

(1) SUBSECTION (a).—The amendments made by subsection (a) shall apply to plans established after December 31, 2000.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to plan years beginning after December 31, 2000.

Subtitle B—Enhancing Fairness for Women

SEC. 1221. CATCHUP CONTRIBUTIONS FOR INDIVIDUALS AGE 50 OR OVER.

(a) IN GENERAL.—Section 414 (relating to definitions and special rules) is amended by adding at the end the following new subsection:

"(v) CATCHUP CONTRIBUTIONS FOR INDIVIDUALS AGE 50 OR OVER.—

"(1) IN GENERAL.—An applicable employer plan shall not be treated as failing to meet any requirement of this title solely because the plan permits an eligible participant to make additional elective deferrals in any plan year.

"(2) LIMITATION ON AMOUNT OF ADDITIONAL DEFERRALS.—

"(A) IN GENERAL.—A plan shall not permit additional elective deferrals under paragraph (1) for any year in an amount greater than the lesser of—

"(i) the applicable percentage of the applicable dollar amount for such elective deferrals for such year, or

"(ii) the excess (if any) of—

"(I) the participant's compensation for the year, over

"(II) any other elective deferrals of the participant for such year which are made without regard to this subsection.

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in:	***The applicable percentage is:***
2001	*10 percent*
2002	*20 percent*
2003	*30 percent*
2004	*40 percent*
2005 and thereafter	*50 percent.*

"(3) TREATMENT OF CONTRIBUTIONS.—In the case of any contribution to a plan under paragraph (1)—

"(A) such contribution shall not, with respect to the year in which the contribution is made—

"(i) be subject to any otherwise applicable limitation contained in section 402(g), 402(h), 403(b), 404(a), 404(h), 408, 415, or 457, or

"(ii) be taken into account in applying such limitations to other contributions or benefits under such plan or any other such plan, and

"(B) such plan shall not be treated as failing to meet the requirements of section 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 401(m), 403(b)(12), 408(k), 408(p), 408B, 410(b), or 416 by reason of the making of (or the right to make) such contribution.

"(4) ELIGIBLE PARTICIPANT.—For purposes of this subsection, the term 'eligible participant' means, with respect to any plan year, a participant in a plan—

"(A) who has attained the age of 50 before the close of the plan year, and

"(B) with respect to whom no other elective deferrals may (without regard to this subsection) be made to the plan for the plan year by reason of the application of any limitation or other restriction described in paragraph (3) or contained in the terms of the plan.

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

"(A) APPLICABLE DOLLAR AMOUNT.—The term 'applicable dollar amount' means, with respect to any year, the amount in effect under section 402(g)(1)(B), 408(p)(2)(E)(i), or 457(e)(15)(A), whichever is applicable to an applicable employer plan, for such year.

"(B) APPLICABLE EMPLOYER PLAN.—The term 'applicable employer plan' means—

"(i) an employees' trust described in section 401(a) which is exempt from tax under section 501(a),

"(ii) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b),

"(iii) an eligible deferred compensation plan under section 457 of an eligible employer as defined in section 457(e)(1)(A), and

"(iv) an arrangement meeting the requirements of section 408 (k) or (p).

"(C) ELECTIVE DEFERRAL.—The term 'elective deferral' has the meaning given such term by subsection (u)(2)(C).

"(D) EXCEPTION FOR SECTION 457 PLANS.—This subsection shall not apply to an applicable employer plan described in subparagraph (B)(iii) for any year to which section 457(b)(3) applies.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions in taxable years beginning after December 31, 2000.

SEC. 1222. EQUITABLE TREATMENT FOR CONTRIBUTIONS OF EMPLOYEES TO DEFINED CONTRIBUTION PLANS.

(a) EQUITABLE TREATMENT.—

(1) IN GENERAL.—Subparagraph (B) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "25 percent" and inserting "100 percent".

(2) APPLICATION TO SECTION 403(b).—Section 403(b) is amended—

(A) by striking "the exclusion allowance for such taxable year" in paragraph (1) and inserting "the applicable limit under section 415",

(B) by striking paragraph (2), and

(C) by inserting "or any amount received by a former employee after the 5th taxable year following the taxable year in which such employee was terminated" before the period at the end of the second sentence of paragraph (3).

(3) CONFORMING AMENDMENTS.—

(A) Subsection (f) of section 72 is amended by striking "section 403(b)(2)(D)(iii))" and inserting "section 403(b)(2)(D)(iii), as in effect before the enactment of the Taxpayer Refund and Relief Act of 1999)".

(B) Section 404(a)(10)(B) is amended by striking ", the exclusion allowance under section 403(b)(2),".

(C) Section 415(a)(2) is amended by striking ", and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2)".

(D) Section 415(c)(3) is amended by adding at the end the following new subparagraph:

"(E) ANNUITY CONTRACTS.—In the case of an annuity contract described in section 403(b), the term 'participant's compensation' means the participant's includible compensation determined under section 403(b)(3).".

(E) Section 415(c) is amended by striking paragraph (4).

(F) Section 415(c)(7) is amended to read as follows:

"(7) CERTAIN CONTRIBUTIONS BY CHURCH PLANS NOT TREATED AS EXCEEDING LIMIT.—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection, at the election of a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), contributions and other additions for an annuity contract or retirement income account described in section 403(b) with respect to such participant, when expressed as an annual addition to such participant's account, shall be treated as not exceeding the limitation of paragraph (1) if such annual addition is not in excess of $10,000.

"(B) $40,000 AGGREGATE LIMITATION.—The total amount of additions with respect to any participant which may be taken into account for purposes of this subparagraph for all years may not exceed $40,000.

"(C) ANNUAL ADDITION.—For purposes of this paragraph, the term 'annual addition' has the meaning given such term by paragraph (2).".

(G) Subparagraph (B) of section 402(g)(7) (as redesignated by section 1201) is amended by inserting before the period at the end the following: "(as in effect before the enactment of the Taxpayer Refund and Relief Act of 1999)".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2000.

(b) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—

(1) IN GENERAL.—Subsection (k) of section 415 is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—For purposes of this section, any annuity contract described in section 403(b) for the benefit of a participant shall be treated as a defined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). For purposes of this section, any contribution by an employer to a simplified employee pension plan for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year.".

(2) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendment made by paragraph (1) shall apply to limitation years beginning after December 31, 1999.

(B) EXCLUSION ALLOWANCE.—Effective for limitation years beginning in 2000, in the case of any annuity contract described in section 403(b) of the Internal Revenue

Code of 1986, the amount of the contribution disqualified by reason of section 415(g) of such Code shall reduce the exclusion allowance as provided in section 403(b)(2) of such Code.

(3) MODIFICATION OF 403(b) EXCLUSION ALLOWANCE TO CONFORM TO 415 MODIFICATION.—The Secretary of the Treasury shall modify the regulations regarding the exclusion allowance under section 403(b)(2) of the Internal Revenue Code of 1986 to render void the requirement that contributions to a defined benefit pension plan be treated as previously excluded amounts for purposes of the exclusion allowance. For taxable years beginning after December 31, 1999, such regulations shall be applied as if such requirement were void.

(c) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Subparagraph (B) of section 457(b)(2) (relating to salary limitation on eligible deferred compensation plans) is amended by striking "33⅓ percent" and inserting "100 percent".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2000.

SEC. 1223. FASTER VESTING OF CERTAIN EMPLOYER MATCHING CONTRIBUTIONS.

(a) AMENDMENTS TO 1986 CODE.—Section 411(a) (relating to minimum vesting standards) is amended—

(1) in paragraph (2), by striking "A plan" and inserting "Except as provided in paragraph (12), a plan", and

(2) by adding at the end the following:

"(12) FASTER VESTING FOR MATCHING CONTRIBUTIONS.—In the case of matching contributions (as defined in section 401(m)(4)(A)), paragraph (2) shall be applied—

"(A) by substituting '3 years' for '5 years' in subparagraph (A), and

"(B) by substituting the following table for the table contained in subparagraph (B):

"Years of service:	***The nonforfeitable percentage is:***
2	*20*
3	*40*
4	*60*
5	*80*
6	*100.".*

(b) AMENDMENTS TO ERISA.—Section 203(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(a)) is amended—

(1) in paragraph (2), by striking "A plan" and inserting "Except as provided in paragraph (4), a plan", and

(2) by adding at the end the following:

"(4) FASTER VESTING FOR MATCHING CONTRIBUTIONS.—In the case of matching contributions (as defined in section 401(m)(4)(A) of the Internal Revenue Code of 1986), paragraph (2) shall be applied—

"(A) by substituting '3 years' for '5 years' in subparagraph (A), and

"(B) by substituting the following table for the table contained in subparagraph (B):

"Years of service:	*The nonforfeitable percentage is:*
2	*20*
3	*40*
4	*60*
5	*80*
6	*100.".*

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contributions for plan years beginning after December 31, 2000.

(2) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified by the date of enactment of this Act, the amendments made by this section shall not apply to contributions on behalf of employees covered by any such agreement for plan years beginning before the earlier of—

(A) the later of—

(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after such date of enactment), or

(ii) January 1, 2001, or

(B) January 1, 2005.

(3) SERVICE REQUIRED.—With respect to any plan, the amendments made by this section shall not apply to any employee before the date that such employee has 1 hour of service under such plan in any plan year to which the amendments made by this section apply.

SEC. 1224. SIMPLIFY AND UPDATE THE MINIMUM DISTRIBUTION RULES.

(a) SIMPLIFICATION AND FINALIZATION OF MINIMUM DISTRIBUTION REQUIREMENTS.—

(1) IN GENERAL.—The Secretary of the Treasury shall—

(A) simplify and finalize the regulations relating to minimum distribution requirements under sections 401(a)(9), 408(a)(6) and (b)(3), 403(b)(10), and 457(d)(2) of the Internal Revenue Code of 1986, and

(B) modify such regulations to—

(i) reflect current life expectancy, and

(ii) revise the required distribution methods so that, under reasonable assumptions, the amount of the required minimum distribution does not decrease over a participant's life expectancy.

(2) FRESH START.—Notwithstanding subparagraph (D) of section 401(a)(9) of such Code, during the first year that regulations are in effect under this subsection, required distributions for future years may be redetermined to reflect changes under such regulations. Such redetermination shall include the opportunity to choose a new designated beneficiary and to elect a new method of calculating life expectancy.

(3) EFFECTIVE DATE FOR REGULATIONS.—Regulations referred to in paragraph (1) shall be effective for years beginning after December 31, 2000, and shall apply in such years without

regard to whether an individual had previously begun receiving minimum distributions.

(b) REPEAL OF RULE WHERE DISTRIBUTIONS HAD BEGUN BEFORE DEATH OCCURS.—

(1) IN GENERAL.—Subparagraph (B) of section 401(a)(9) is amended by striking clause (i) and redesignating clauses (ii), (iii), and (iv) as clauses (i), (ii), and (iii), respectively.

(2) CONFORMING CHANGES.—

(A) Clause (i) of section 401(a)(9)(B) (as so redesignated) is amended—

(i) by striking "FOR OTHER CASES" in the heading, and

(ii) by striking "the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii)" and inserting "his entire interest has been distributed to him,".

(B) Clause (ii) of section 401(a)(9)(B) (as so redesignated) is amended by striking "clause (ii)" and inserting "clause (i)".

(C) Clause (iii) of section 401(a)(9)(B) (as so redesignated) is amended—

(i) by striking "clause (iii)(I)" and inserting "clause (ii)(I)",

(ii) by striking "clause (iii)(III)" in subclause (I) and inserting "clause (ii)(III)",

(iii) by striking "the date on which the employee would have attained the age 70½," in subclause (I) and inserting "April 1 of the calendar year following the calendar year in which the spouse attains 70½,", and

(iv) by striking "the distributions to such spouse begin," in subclause (II) and inserting "his entire interest has been distributed to him,".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2000.

(c) REDUCTION IN EXCISE TAX.—

(1) IN GENERAL.—Subsection (a) of section 4974 is amended by striking "50 percent" and inserting "10 percent".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2000.

SEC. 1225. CLARIFICATION OF TAX TREATMENT OF DIVISION OF SECTION 457 PLAN BENEFITS UPON DIVORCE.

(a) IN GENERAL.—Section 414(p)(11) (relating to application of rules to governmental and church plans) is amended—

(1) by inserting "or an eligible deferred compensation plan (within the meaning of section 457(b))" after "subsection (e))", and

(2) in the heading, by striking "GOVERNMENTAL AND CHURCH PLANS" and inserting "CERTAIN OTHER PLANS".

(b) WAIVER OF CERTAIN DISTRIBUTION REQUIREMENTS.—Paragraph (10) of section 414(p) is amended by striking "and section 409(d)" and inserting "section 409(d), and section 457(d)".

(c) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—Subsection (p) of section 414 is amended by redesignating

paragraph (12) as paragraph (13) and inserting after paragraph (11) the following new paragraph:

"(12) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—If a distribution or payment from an eligible deferred compensation plan described in section 457(b) is made pursuant to a qualified domestic relations order, rules similar to the rules of section 402(e)(1)(A) shall apply to such distribution or payment.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers, distributions, and payments made after December 31, 2000.

SEC. 1226. MODIFICATION OF SAFE HARBOR RELIEF FOR HARDSHIP WITHDRAWALS FROM CASH OR DEFERRED ARRANGEMENTS.

(a) IN GENERAL.—The Secretary of the Treasury shall revise the regulations relating to hardship distributions under section 401(k)(2)(B)(i)(IV) of the Internal Revenue Code of 1986 to provide that the period an employee is prohibited from making elective and employee contributions in order for a distribution to be deemed necessary to satisfy financial need shall be equal to 6 months.

(b) EFFECTIVE DATE.—The revised regulations under subsection (a) shall apply to years beginning after December 31, 2000.

Subtitle C—Increasing Portability for Participants

SEC. 1231. ROLLOVERS ALLOWED AMONG VARIOUS TYPES OF PLANS.

(a) ROLLOVERS FROM AND TO SECTION 457 PLANS.—

(1) ROLLOVERS FROM SECTION 457 PLANS.—

(A) IN GENERAL.—Section 457(e) (relating to other definitions and special rules) is amended by adding at the end the following:

"(16) ROLLOVER AMOUNTS.—

"(A) GENERAL RULE.—In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A), if—

"(i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4) without regard to subparagraph (C) thereof),

"(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and

"(iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) (other than paragraph (4)(C))

and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A).

"(C) REPORTING.—Rollovers under this paragraph shall be reported to the Secretary in the same manner as rollovers from qualified retirement plans (as defined in section 4974(c)).".

(B) DEFERRAL LIMIT DETERMINED WITHOUT REGARD TO ROLLOVER AMOUNTS.—Section 457(b)(2) (defining eligible deferred compensation plan) is amended by inserting "(other than rollover amounts)" after "taxable year".

(C) DIRECT ROLLOVER.—Paragraph (1) of section 457(d) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following:

"(C) in the case of a plan maintained by an employer described in subsection (e)(1)(A), the plan meets requirements similar to the requirements of section 401(a)(31).

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of transfer.".

(D) WITHHOLDING.—

(i) Paragraph (12) of section 3401(a) is amended by adding at the end the following:

"(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) maintained by an employer described in section 457(e)(1)(A); or".

(ii) Paragraph (3) of section 3405(c) is amended to read as follows:

"(3) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this subsection, the term 'eligible rollover distribution' has the meaning given such term by section 402(f)(2)(A).".

(iii) LIABILITY FOR WITHHOLDING.—Subparagraph (B) of section 3405(d)(2) is amended by striking "or" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", or", and by adding at the end the following:

"(iv) section 457(b).".

(2) ROLLOVERS TO SECTION 457 PLANS.—

(A) IN GENERAL.—Section 402(c)(8)(B) (defining eligible retirement plan) is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by inserting after clause (iv) the following new clause:

"(v) an eligible deferred compensation plan described in section 457(b) of an employer described in section 457(e)(1)(A).".

(B) SEPARATE ACCOUNTING.—Section 402(c) is amended by adding at the end the following new paragraph:

"(11) SEPARATE ACCOUNTING.—Unless a plan described in clause (v) of paragraph (8)(B) agrees to separately account for amounts rolled into such plan from eligible retirement plans not described in such clause, the plan described in such clause

may not accept transfers or rollovers from such retirement plans.".

(C) 10 PERCENT ADDITIONAL TAX.—Subsection (t) of section 72 (relating to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding at the end the following new paragraph:

"(9) SPECIAL RULE FOR ROLLOVERS TO SECTION 457 PLANS.—For purposes of this subsection, a distribution from an eligible deferred compensation plan (as defined in section 457(b)) of an employer described in section 457(e)(1)(A) shall be treated as a distribution from a qualified retirement plan described in 4974(c)(1) to the extent that such distribution is attributable to an amount transferred to an eligible deferred compensation plan from a qualified retirement plan (as defined in section 4974(c)).".

(b) ALLOWANCE OF ROLLOVERS FROM AND TO 403(b) PLANS.—

(1) ROLLOVERS FROM SECTION 403(b) PLANS.—Section 403(b)(8)(A)(ii) (relating to rollover amounts) is amended by striking "such distribution" and all that follows and inserting "such distribution to an eligible retirement plan described in section 402(c)(8)(B), and".

(2) ROLLOVERS TO SECTION 403(b) PLANS.—Section 402(c)(8)(B) (defining eligible retirement plan), as amended by subsection (a), is amended by striking "and" at the end of clause (iv), by striking the period at the end of clause (v) and inserting ", and", and by inserting after clause (v) the following new clause:

"(vi) an annuity contract described in section 403(b).".

(c) EXPANDED EXPLANATION TO RECIPIENTS OF ROLLOVER DISTRIBUTIONS.—Paragraph (1) of section 402(f) (relating to written explanation to recipients of distributions eligible for rollover treatment) 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) of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making such distribution.".

(d) SPOUSAL ROLLOVERS.—Section 402(c)(9) (relating to rollover where spouse receives distribution after death of employee) is amended by striking "; except that" and all that follows up to the end period.

(e) CONFORMING AMENDMENTS.—

(1) Section 72(o)(4) is amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(2) Section 219(d)(2) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(3) Section 401(a)(31)(B) is amended by striking "and 403(a)(4)" and inserting ", 403(a)(4), 403(b)(8), and 457(e)(16)".

(4) Subparagraph (A) of section 402(f)(2) is amended by striking "or paragraph (4) of section 403(a)" and inserting ",

paragraph (4) of section 403(a), subparagraph (A) of section 403(b)(8), or subparagraph (A) of section 457(e)(16)".

(5) Paragraph (1) of section 402(f) is amended by striking "from an eligible retirement plan".

(6) Subparagraphs (A) and (B) of section 402(f)(1) are amended by striking "another eligible retirement plan" and inserting "an eligible retirement plan".

(7) Subparagraph (B) of section 403(b)(8) is amended to read as follows:

> *"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A), except that section 402(f) shall be applied to the payor in lieu of the plan administrator.".*

(8) Section 408(a)(1) is amended by striking "or 403(b)(8)" and inserting ", 403(b)(8), or 457(e)(16)".

(9) Subparagraphs (A) and (B) of section 415(b)(2) are each amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(10) Section 415(c)(2) is amended by striking "and 408(d)(3)" and inserting "408(d)(3), and 457(e)(16)".

(11) Section 4973(b)(1)(A) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(f) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

(2) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of any amendment made by this section.

SEC. 1232. ROLLOVERS OF IRAS INTO WORKPLACE RETIREMENT PLANS.

(a) IN GENERAL.—Subparagraph (A) of section 408(d)(3) (relating to rollover amounts) is amended by adding "or" at the end of clause (i), by striking clauses (ii) and (iii), and by adding at the end the following:

> *"(ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to this paragraph).*

For purposes of clause (ii), the term 'eligible retirement plan' means an eligible retirement plan described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B).".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 403(b) is amended by striking "section 408(d)(3)(A)(iii)" and inserting "section 408(d)(3)(A)(ii)".

(2) Clause (i) of section 408(d)(3)(D) is amended by striking "(i), (ii), or (iii)" and inserting "(i) or (ii)".

(3) Subparagraph (G) of section 408(d)(3) is amended to read as follows:

"(G) SIMPLE RETIREMENT ACCOUNTS.—In the case of any payment or distribution out of a simple retirement account (as defined in subsection (p)) to which section 72(t)(6) applies, this paragraph shall not apply unless such payment or distribution is paid into another simple retirement account.".

(c) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

(2) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of the amendments made by this section.

SEC. 1233. ROLLOVERS OF AFTER-TAX CONTRIBUTIONS.

(a) ROLLOVERS FROM EXEMPT TRUSTS.—Paragraph (2) of section 402(c) (relating to maximum amount which may be rolled over) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution to the extent—

"(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust which is part of a plan which is a defined contribution plan and which agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

"(B) such portion is transferred to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B).".

(b) OPTIONAL DIRECT TRANSFER OF ELIGIBLE ROLLOVER DISTRIBUTIONS.—Subparagraph (B) of section 401(a)(31) (relating to limitation) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution if the plan to which such distribution is transferred—

"(i) agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

"(ii) is an eligible retirement plan described in clause (i) or (ii) of section 402(c)(8)(B).".

(c) RULES FOR APPLYING SECTION 72 TO IRAS.—Paragraph (3) of section 408(d) (relating to special rules for applying section 72) is amended by inserting at the end the following:

"(H) APPLICATION OF SECTION 72.—

"(i) IN GENERAL.—If—

"(I) a distribution is made from an individual retirement plan, and

"(II) a rollover contribution is made to an eligible retirement plan described in section 402(c)(8)(B)(iii), (iv), (v), or (vi) with respect to all or part of such distribution,

then, notwithstanding paragraph (2), the rules of clause (ii) shall apply for purposes of applying section 72.

"(ii) APPLICABLE RULES.—In the case of a distribution described in clause (i)—

"(I) section 72 shall be applied separately to such distribution,

"(II) notwithstanding the pro rata allocation of income on, and investment in, the contract to distributions under section 72, the portion of such distribution rolled over to an eligible retirement plan described in clause (i) shall be treated as from income on the contract (to the extent of the aggregate income on the contract from all individual retirement plans of the distributee), and

"(III) appropriate adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after December 31, 2000.

SEC. 1234. HARDSHIP EXCEPTION TO 60-DAY RULE.

(a) EXEMPT TRUSTS.—Paragraph (3) of section 402(c) (relating to transfer must be made within 60 days of receipt) is amended to read as follows:

"(3) TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), paragraph (1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

"(B) HARDSHIP EXCEPTION.—The Secretary may waive the 60-day requirement under subparagraph (A) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(b) IRAS.—Paragraph (3) of section 408(d) (relating to rollover contributions), as amended by section 1233, is amended by adding after subparagraph (H) the following new subparagraph:

"(I) WAIVER OF 60-DAY REQUIREMENT.—The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1235. TREATMENT OF FORMS OF DISTRIBUTION.

(a) PLAN TRANSFERS.—

(1) AMENDMENT TO INTERNAL REVENUE CODE OF 1986.—Paragraph (6) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended by adding at the end the following:

"(D) PLAN TRANSFERS.—

"(i) A defined contribution plan (in this subparagraph referred to as the 'transferee plan') shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the 'transferor plan') to the extent that—

"(I) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan,

"(II) the terms of both the transferor plan and the transferee plan authorize the transfer described in subclause (I),

"(III) the transfer described in subclause (I) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan,

"(IV) the election described in subclause (III) was made after the participant or beneficiary received a notice describing the consequences of making the election,

"(V) if the transferor plan provides for an annuity as the normal form of distribution under the plan in accordance with section 417, the transfer is made with the consent of the participant's spouse (if any), and such consent meets requirements similar to the requirements imposed by section 417(a)(2), and

"(VI) the transferee plan allows the participant or beneficiary described in clause (iii) to receive any distribution to which the participant or beneficiary is entitled under the transferee plan in the form of a single sum distribution.

"(ii) Clause (i) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

"(E) ELIMINATION OF FORM OF DISTRIBUTION.—Except to the extent provided in regulations, a defined contribution plan shall not be treated as failing to meet the requirements of this section merely because of the elimination of a form of distribution previously available thereunder. This

subparagraph shall not apply to the elimination of a form of distribution with respect to any participant unless—

"(i) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated, and

"(ii) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.".

(2) AMENDMENT TO ERISA.—Section 204(g) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(g)) is amended by adding at the end the following:

"(4)(A) A defined contribution plan (in this subparagraph referred to as the 'transferee plan') shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the 'transferor plan') to the extent that—

"(i) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan;

"(ii) the terms of both the transferor plan and the transferee plan authorize the transfer described in clause (i);

"(iii) the transfer described in clause (i) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan;

"(iv) the election described in clause (iii) was made after the participant or beneficiary received a notice describing the consequences of making the election;

"(v) if the transferor plan provides for an annuity as the normal form of distribution under the plan in accordance with section 205, the transfer is made with the consent of the participant's spouse (if any), and such consent meets requirements similar to the requirements imposed by section 205(c)(2); and

"(vi) the transferee plan allows the participant or beneficiary described in clause (iii) to receive any distribution to which the participant or beneficiary is entitled under the transferee plan in the form of a single sum distribution.

"(B) Subparagraph (A) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

"(5) ELIMINATION OF FORM OF DISTRIBUTION.—Except to the extent provided in regulations, a defined contribution plan shall not be treated as failing to meet the requirements of this section merely because of the elimination of a form of distribution previously available thereunder. This paragraph shall not apply to the elimination of a form of distribution with respect to any participant unless—

"(A) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated; and

"(B) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2000.

(b) REGULATIONS.—

(1) AMENDMENT TO INTERNAL REVENUE CODE OF 1986.—The last sentence of paragraph (6)(B) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended to read as follows: "The Secretary shall by regulations provide that this subparagraph shall not apply to any plan amendment that does not adversely affect the rights of participants in a material manner.".

(2) AMENDMENT TO ERISA.—The last sentence of section 204(g)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(g)(2)) is amended to read as follows: "The Secretary of the Treasury shall by regulations provide that this paragraph shall not apply to any plan amendment that does not adversely affect the rights of participants in a material manner.".

(3) SECRETARY DIRECTED.—Not later than December 31, 2001, the Secretary of the Treasury is directed to issue final regulations under section 411(d)(6) of the Internal Revenue Code of 1986 and section 204(g) of the Employee Retirement Income Security Act of 1974, including the regulations required by the amendments made by this subsection. Such regulations shall apply to plan years beginning after December 31, 2001, or such earlier date as is specified by the Secretary of the Treasury.

SEC. 1236. RATIONALIZATION OF RESTRICTIONS ON DISTRIBUTIONS.

(a) MODIFICATION OF SAME DESK EXCEPTION.—

(1) SECTION 401(k).—

(A) Section 401(k)(2)(B)(i)(I) (relating to qualified cash or deferred arrangements) is amended by striking "separation from service" and inserting "severance from employment".

(B) Subparagraph (A) of section 401(k)(10) (relating to distributions upon termination of plan or disposition of assets or subsidiary) is amended to read as follows:

"(A) IN GENERAL.—An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other than an employee stock ownership plan as defined in section 4975(e)(7)).".

(C) Section 401(k)(10) is amended—

(i) in subparagraph (B)—

(I) by striking "An event" in clause (i) and inserting "A termination", and

(II) by striking "the event" in clause (i) and inserting "the termination",

(ii) by striking subparagraph (C), and

(iii) by striking "OR DISPOSITION OF ASSETS OR SUBSIDIARY" in the heading.

(2) SECTION 403(b).—

(A) Paragraphs (7)(A)(ii) and (11)(A) of section 403(b) are each amended by striking "separates from service" and inserting "has a severance from employment".

(B) The heading for paragraph (11) of section 403(b) is amended by striking "SEPARATION FROM SERVICE" and inserting "SEVERANCE FROM EMPLOYMENT".

(3) SECTION 457.—Clause (ii) of section 457(d)(1)(A) is amended by striking "is separated from service" and inserting "has a severance from employment".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1237. PURCHASE OF SERVICE CREDIT IN GOVERNMENTAL DEFINED BENEFIT PLANS.

(a) 403(b) PLANS.—Subsection (b) of section 403 is amended by adding at the end the following new paragraph:

"(13) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(b) 457 PLANS.—

(1) Subsection (e) of section 457 is amended by adding after paragraph (16) the following new paragraph:

"(17) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(2) Section 457(b)(2) is amended by striking "(other than rollover amounts)" and inserting "(other than rollover amounts and amounts received in a transfer referred to in subsection (e)(17))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to trustee-to-trustee transfers after December 31, 2000.

SEC. 1238. EMPLOYERS MAY DISREGARD ROLLOVERS FOR PURPOSES OF CASH-OUT AMOUNTS.

(a) QUALIFIED PLANS.—

(1) AMENDMENT TO INTERNAL REVENUE CODE OF 1986.—Section 411(a)(11) (relating to restrictions on certain mandatory distributions) is amended by adding at the end the following:

"(D) SPECIAL RULE FOR ROLLOVER CONTRIBUTIONS.—A plan shall not fail to meet the requirements of this paragraph if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For

purposes of this subparagraph, the term 'rollover contributions' means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16).".

(2) AMENDMENT TO ERISA.—Section 203(e) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(c)) is amended by adding at the end the following:

"(4) A plan shall not fail to meet the requirements of this subsection if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For purposes of this subparagraph, the term 'rollover contributions' means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16) of the Internal Revenue Code of 1986.".

(b) ELIGIBLE DEFERRED COMPENSATION PLANS.—Clause (i) of section 457(e)(9)(A) is amended by striking "such amount" and inserting "the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

SEC. 1239. MINIMUM DISTRIBUTION AND INCLUSION REQUIREMENTS FOR SECTION 457 PLANS.

(a) MINIMUM DISTRIBUTION REQUIREMENTS.—Paragraph (2) of section 457(d) (relating to distribution requirements) is amended to read as follows:

"(2) MINIMUM DISTRIBUTION REQUIREMENTS.—A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of section 401(a)(9).".

(b) INCLUSION IN GROSS INCOME.—

(1) YEAR OF INCLUSION.—Subsection (a) of section 457 (relating to year of inclusion in gross income) is amended to read as follows:

"(a) YEAR OF INCLUSION IN GROSS INCOME.—

"(1) IN GENERAL.—Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income—

"(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

"(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

"(2) SPECIAL RULE FOR ROLLOVER AMOUNTS.—To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.".

(2) CONFORMING AMENDMENTS.—

(A) So much of paragraph (9) of section 457(e) as precedes subparagraph (A) is amended to read as follows:

"(9) BENEFITS OF TAX EXEMPT ORGANIZATION PLANS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELEC-

TIONS, ETC.—In the case of an eligible deferred compensation plan of an employer described in subsection (e)(1)(B)—".

(B) Section 457(d) is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULE FOR GOVERNMENT PLAN.—An eligible deferred compensation plan of an employer described in subsection (e)(1)(A) shall not be treated as failing to meet the requirements of this subsection solely by reason of making a distribution described in subsection (e)(9)(A)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2000.

Subtitle D—Strengthening Pension Security and Enforcement

SEC. 1241. REPEAL OF 150 PERCENT OF CURRENT LIABILITY FUNDING LIMIT.

(a) AMENDMENT TO INTERNAL REVENUE CODE OF 1986.—Section 412(c)(7) (relating to full-funding limitation) is amended—

(1) by striking "the applicable percentage" in subparagraph (A)(i)(I) and inserting "in the case of plan years beginning before January 1, 2004, the applicable percentage", and

(2) by amending subparagraph (F) to read as follows:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	*The applicable percentage is—*
2001	*160*
2002	*165*
2003	*170.".*

(b) AMENDMENT TO ERISA.—Section 302(c)(7) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)) is amended—

(1) by striking "the applicable percentage" in subparagraph (A)(i)(I) and inserting "in the case of plan years beginning before January 1, 2004, the applicable percentage", and

(2) by amending subparagraph (F) to read as follows:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	*The applicable percentage is—*
2001	*160*
2002	*165*
2003	*170.".*

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1242. MAXIMUM CONTRIBUTION DEDUCTION RULES MODIFIED AND APPLIED TO ALL DEFINED BENEFIT PLANS.

(a) IN GENERAL.—Subparagraph (D) of section 404(a)(1) (relating to special rule in case of certain plans) is amended to read as follows:

"(D) SPECIAL RULE IN CASE OF CERTAIN PLANS.—

"(i) IN GENERAL.—In the case of any defined benefit plan, except as provided in regulations, the max-

imum amount deductible under the limitations of this paragraph shall not be less than the unfunded termination liability (determined as if the proposed termination date referred to in section 4041(b)(2)(A)(i)(II) of the Employee Retirement Income Security Act of 1974 were the last day of the plan year).

"(ii) PLANS WITH LESS THAN 100 PARTICIPANTS.—For purposes of this subparagraph, in the case of a plan which has less than 100 participants for the plan year, termination liability shall not include the liability attributable to benefit increases for highly compensated employees (as defined in section 414(q)) resulting from a plan amendment which is made or becomes effective, whichever is later, within the last 2 years before the termination date.

"(iii) RULE FOR DETERMINING NUMBER OF PARTICIPANTS.—For purposes of determining whether a plan has more than 100 participants, all defined benefit plans maintained by the same employer (or any member of such employer's controlled group (within the meaning of section 412(l)(8)(C))) shall be treated as 1 plan, but only employees of such member or employer shall be taken into account.

"(iv) PLANS ESTABLISHED AND MAINTAIN BY PROFESSIONAL SERVICE EMPLOYERS.—Clause (i) shall not apply to a plan described in section 4021(b)(13) of the Employee Retirement Income Security Act of 1974.".

(b) CONFORMING AMENDMENT.—Paragraph (6) of section 4972(c) is amended to read as follows:

"(6) EXCEPTIONS.—In determining the amount of nondeductible contributions for any taxable year, there shall not be taken into account so much of the contributions to 1 or more defined contribution plans which are not deductible when contributed solely because of section 404(a)(7) as does not exceed the greater of—

"(A) the amount of contributions not in excess of 6 percent of compensation (within the meaning of section 404(a)) paid or accrued (during the taxable year for which the contributions were made) to beneficiaries under the plans, or

"(B) the sum of—

"(i) the amount of contributions described in section 401(m)(4)(A), plus

"(ii) the amount of contributions described in section 402(g)(3)(A).

For purposes of this paragraph, the deductible limits under section 404(a)(7) shall first be applied to amounts contributed to a defined benefit plan and then to amounts described in subparagraph (B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1243. MISSING PARTICIPANTS.

(a) IN GENERAL.—Section 4050 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1350) is amended by redesig-

nating subsection (c) as subsection (e) and by inserting after subsection (b) the following:

"(c) MULTIEMPLOYER PLANS.—The corporation shall prescribe rules similar to the rules in subsection (a) for multiemployer plans covered by this title that terminate under section 4041A.

"(d) PLANS NOT OTHERWISE SUBJECT TO TITLE.—

"(1) TRANSFER TO CORPORATION.—The plan administrator of a plan described in paragraph (4) may elect to transfer a missing participant's benefits to the corporation upon termination of the plan.

"(2) INFORMATION TO THE CORPORATION.—To the extent provided in regulations, the plan administrator of a plan described in paragraph (4) shall, upon termination of the plan, provide the corporation information with respect to benefits of a missing participant if the plan transfers such benefits—

"(A) to the corporation, or

"(B) to an entity other than the corporation or a plan described in paragraph (4)(B)(ii).

"(3) PAYMENT BY THE CORPORATION.—If benefits of a missing participant were transferred to the corporation under paragraph (1), the corporation shall, upon location of the participant or beneficiary, pay to the participant or beneficiary the amount transferred (or the appropriate survivor benefit) either—

"(A) in a single sum (plus interest), or

"(B) in such other form as is specified in regulations of the corporation.

"(4) PLANS DESCRIBED.—A plan is described in this paragraph if—

"(A) the plan is a pension plan (within the meaning of section 3(2))—

"(i) to which the provisions of this section do not apply (without regard to this subsection), and

"(ii) which is not a plan described in paragraphs (2) through (11) of section 4021(b), and

"(B) at the time the assets are to be distributed upon termination, the plan—

"(i) has missing participants, and

"(ii) has not provided for the transfer of assets to pay the benefits of all missing participants to another pension plan (within the meaning of section 3(2)).

"(5) CERTAIN PROVISIONS NOT TO APPLY.—Subsections (a)(1) and (a)(3) shall not apply to a plan described in paragraph (4).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distributions made after final regulations implementing subsections (c) and (d) of section 4050 of the Employee Retirement Income Security Act of 1974 (as added by subsection (a)), respectively, are prescribed.

SEC. 1244. EXCISE TAX RELIEF FOR SOUND PENSION FUNDING.

(a) IN GENERAL.—Subsection (c) of section 4972 (relating to nondeductible contributions) is amended by adding at the end the following new paragraph:

"(7) DEFINED BENEFIT PLAN EXCEPTION.—In determining the amount of nondeductible contributions for any taxable year, an employer may elect for such year not to take into account any contributions to a defined benefit plan except to the extent that such contributions exceed the full-funding limitation (as defined in section 412(c)(7), determined without regard to subparagraph (A)(i)(I) thereof). For purposes of this paragraph, the deductible limits under section 404(a)(7) shall first be applied to amounts contributed to defined contribution plans and then to amounts described in this paragraph. If an employer makes an election under this paragraph for a taxable year, paragraph (6) shall not apply to such employer for such taxable year.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1245. EXCISE TAX ON FAILURE TO PROVIDE NOTICE BY DEFINED BENEFIT PLANS SIGNIFICANTLY REDUCING FUTURE BENEFIT ACCRUALS.

(a) AMENDMENT TO 1986 CODE.—Chapter 43 of subtitle D (relating to qualified pension, etc., plans) is amended by adding at the end the following new section:

"SEC. 4980F. FAILURE OF APPLICABLE PLANS REDUCING BENEFIT ACCRUALS TO SATISFY NOTICE REQUIREMENTS.

"(a) IMPOSITION OF TAX.—There is hereby imposed a tax on the failure of any applicable pension plan to meet the requirements of subsection (e) with respect to any applicable individual.

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) on any failure with respect to any applicable individual shall be $100 for each day in the noncompliance period with respect to such failure.

"(2) NONCOMPLIANCE PERIOD.—For purposes of this section, the term 'noncompliance period' means, with respect to any failure, the period beginning on the date the failure first occurs and ending on the date the failure is corrected.

"(c) LIMITATIONS ON AMOUNT OF TAX.—

"(1) OVERALL LIMITATION FOR UNINTENTIONAL FAILURES.—In the case of failures that are due to reasonable cause and not to willful neglect, the tax imposed by subsection (a) for failures during the taxable year of the employer (or, in the case of a multiemployer plan, the taxable year of the trust forming part of the plan) shall not exceed $500,000. For purposes of the preceding sentence, all multiemployer plans of which the same trust forms a part shall be treated as 1 plan. For purposes of this paragraph, if not all persons who are treated as a single employer for purposes of this section have the same taxable year, the taxable years taken into account shall be determined under principles similar to the principles of section 1561.

"(2) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive relative to the failure involved.

"(d) LIABILITY FOR TAX.—The following shall be liable for the tax imposed by subsection (a):

"(1) In the case of a plan other than a multiemployer plan, the employer.

"(2) In the case of a multiemployer plan, the plan.

"(e) NOTICE REQUIREMENTS FOR PLANS SIGNIFICANTLY REDUCING BENEFIT ACCRUALS.—

"(1) IN GENERAL.—If an applicable pension plan is amended to provide for a significant reduction in the rate of future benefit accrual, the plan administrator shall provide written notice to each applicable individual (and to each employee organization representing applicable individuals).

"(2) NOTICE.—The notice required by paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary) to allow applicable individuals to understand the effect of the plan amendment.

"(3) TIMING OF NOTICE.—Except as provided in regulations, the notice required by paragraph (1) shall be provided within a reasonable time before the effective date of the plan amendment.

"(4) DESIGNEES.—Any notice under paragraph (1) may be provided to a person designated, in writing, by the person to which it would otherwise be provided.

"(5) NOTICE BEFORE ADOPTION OF AMENDMENT.—A plan shall not be treated as failing to meet the requirements of paragraph (1) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.

"(f) APPLICABLE INDIVIDUAL; APPLICABLE PENSION PLAN.—For purposes of this section—

"(1) APPLICABLE INDIVIDUAL.—The term 'applicable individual' means, with respect to any plan amendment—

"(A) any participant in the plan, and

"(B) any beneficiary who is an alternate payee (within the meaning of section 414(p)(8)) under an applicable qualified domestic relations order (within the meaning of section 414(p)(1)(A)),

who may reasonably be expected to be affected by such plan amendment.

"(2) APPLICABLE PENSION PLAN.—The term 'applicable pension plan' means—

"(A) any defined benefit plan, or

"(B) an individual account plan which is subject to the funding standards of section 412,

which had 100 or more participants who had accrued a benefit, or with respect to whom contributions were made, under the plan (whether or not vested) as of the last day of the plan year preceding the plan year in which the plan amendment becomes effective. Such term shall not include a governmental plan (within the meaning of section 414(d)) or a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.".

(b) AMENDMENT TO ERISA.—Section 204(h) of the Employee Retirement Income Security Act or 1974 (29 U.S.C. 1054(h)) is amended by adding at the end the following new paragraph:

"(3)(A) A plan to which paragraph (1) applies shall not be treated as meeting the requirements of such paragraph unless, in addition to any notice required to be provided to an individual or organization under such paragraph, the plan administrator provides the notice described in subparagraph (B).

"(B) The notice required by subparagraph (A) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary of the Treasury) to allow individuals to understand the effect of the plan amendment.

"(C) Except as provided in regulations prescribed by the Secretary of the Treasury, the notice required by subparagraph (A) shall be provided within a reasonable time before the effective date of the plan amendment.

"(D) A plan shall not be treated as failing to meet the requirements of subparagraph (A) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.".

(c) CLERICAL AMENDMENT.—The table of sections for chapter 43 of subtitle D is amended by adding at the end the following new item:

"Sec. 4980F. Failure of applicable plans reducing benefit accruals to satisfy notice requirements.".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan amendments taking effect on or after the date of the enactment of this Act.

(2) TRANSITION.—Until such time as the Secretary of the Treasury issues regulations under sections 4980F(e)(2) and (3) of the Internal Revenue Code of 1986 and section 204(h)(3) of the Employee Retirement Income Security Act of 1974 (as added by the amendments made by this section), a plan shall be treated as meeting the requirements of such sections if it makes a good faith effort to comply with such requirements.

(3) SPECIAL RULE.—The period for providing any notice required by the amendments made by this section shall not end before the date which is 3 months after the date of the enactment of this Act.

SEC. 1246. PROTECTION OF INVESTMENT OF EMPLOYEE CONTRIBUTIONS TO 401(K) PLANS.

(a) IN GENERAL.—Section 1524(b) of the Taxpayer Relief Act of 1997 is amended to read as follows:

"(b) EFFECTIVE DATE.—

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

"(2) NONAPPLICATION TO PREVIOUSLY ACQUIRED PROPERTY.—The amendments made by this section shall not apply to any elective deferral which is invested in assets consisting of qualifying employer securities, qualifying employer real prop-

erty, or both, if such assets were acquired before January 1, 1999."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply as if included in the provision of the Taxpayer Relief Act of 1997 to which it relates.

SEC. 1247. TREATMENT OF MULTIEMPLOYER PLANS UNDER SECTION 415.

(a) COMPENSATION LIMIT.—Paragraph (11) of section 415(b) (relating to limitation for defined benefit plans) is amended to read as follows:

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

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

Subtitle E—Reducing Regulatory Burdens

SEC. 1251. MODIFICATION OF TIMING OF PLAN VALUATIONS.

(a) IN GENERAL.—Section 412(c)(9) (relating to annual valuation) is amended—

(1) by striking "For purposes" and inserting the following:

"(A) IN GENERAL.—For purposes", and

(2) by adding at the end the following:

"(B) ELECTION TO USE PRIOR YEAR VALUATION.—

"(i) IN GENERAL.—Except as provided in clause (ii), if, for any plan year—

"(I) an election is in effect under this subparagraph with respect to a plan, and

"(II) the assets of the plan are not less than 125 percent of the plan's current liability (as defined in paragraph (7)(B)), determined as of the valuation date for the preceding plan year,

then this section shall be applied using the information available as of such valuation date.

"(ii) EXCEPTIONS.—

"(I) ACTUAL VALUATION EVERY 3 YEARS.—Clause (i) shall not apply for more than 2 consecutive plan years and valuation shall be under subparagraph (A) with respect to any plan year to which clause (i) does not apply by reason of this subclause.

"(II) REGULATIONS.—Clause (i) shall not apply to the extent that more frequent valuations are required under the regulations under subparagraph (A).

"(iii) ADJUSTMENTS.—Information under clause (i) shall, in accordance with regulations, be actuarially adjusted to reflect significant differences in participants.

"(iv) ELECTION.—An election under this subparagraph, once made, shall be irrevocable without the consent of the Secretary.".

(b) AMENDMENTS TO ERISA.—Paragraph (9) of section 302(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(c)) is amended—

(1) by inserting "(A)" after "(9)", and

(2) by adding at the end the following:

"(B)(i) Except as provided in clause (ii), if, for any plan year—

"(I) an election is in effect under this subparagraph with respect to a plan, and

"(II) the assets of the plan are not less than 125 percent of the plan's current liability (as defined in paragraph (7)(B)), determined as of the valuation date for the preceding plan year, then this section shall be applied using the information available as of such valuation date.

"(ii)(I) Clause (i) shall not apply for more than 2 consecutive plan years and valuation shall be under subparagraph (A) with respect to any plan year to which clause (i) does not apply by reason of this subclause.

"(II) Clause (i) shall not apply to the extent that more frequent valuations are required under the regulations under subparagraph (A).

"(iii) Information under clause (i) shall, in accordance with regulations, be actuarially adjusted to reflect significant differences in participants.

"(iv) An election under this subparagraph, once made, shall be irrevocable without the consent of the Secretary of the Treasury.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

SEC. 1252. ESOP DIVIDENDS MAY BE REINVESTED WITHOUT LOSS OF DIVIDEND DEDUCTION.

(a) IN GENERAL.—Section 404(k)(2)(A) (defining applicable dividends) is amended by striking "or" at the end of clause (ii), by redesignating clause (iii) as clause (iv), and by inserting after clause (ii) the following new clause:

"(iii) is, at the election of such participants or their beneficiaries—

"(I) payable as provided in clause (i) or (ii), or

"(II) paid to the plan and reinvested in qualifying employer securities, or".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1253. REPEAL OF TRANSITION RULE RELATING TO CERTAIN HIGHLY COMPENSATED EMPLOYEES.

(a) IN GENERAL.—Paragraph (4) of section 1114(c) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to plan years beginning after December 31, 1999.

SEC. 1254. EMPLOYEES OF TAX-EXEMPT ENTITIES.

(a) IN GENERAL.—The Secretary of the Treasury shall modify Treasury Regulations section 1.410(b)–6(g) to provide that employees of an organization described in section 403(b)(1)(A)(i) of the Internal

Revenue Code of 1986 who are eligible to make contributions under section 403(b) of such Code pursuant to a salary reduction agreement may be treated as excludable with respect to a plan under section 401 (k) or (m) of such Code that is provided under the same general arrangement as a plan under such section 401(k), if—

(1) no employee of an organization described in section 403(b)(1)(A)(i) of such Code is eligible to participate in such section 401(k) plan or section 401(m) plan, and

(2) 95 percent of the employees who are not employees of an organization described in section 403(b)(1)(A)(i) of such Code are eligible to participate in such plan under such section 401 (k) or (m).

(b) EFFECTIVE DATE.—The modification required by subsection (a) shall apply as of the same date set forth in section 1426(b) of the Small Business Job Protection Act of 1996.

SEC. 1255. CLARIFICATION OF TREATMENT OF EMPLOYER-PROVIDED RETIREMENT ADVICE.

(a) IN GENERAL.—Subsection (a) of section 132 (relating to exclusion from gross income) is amended by striking "or" at the end of paragraph (5), by striking the period at the end of paragraph (6) and inserting ", or", and by adding at the end the following new paragraph:

"(7) qualified retirement planning services.".

(b) QUALIFIED RETIREMENT PLANNING SERVICES DEFINED.—Section 132 is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following:

"(m) QUALIFIED RETIREMENT PLANNING SERVICES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified retirement planning services' means any retirement planning service provided to an employee and his spouse by an employer maintaining a qualified employer plan.

"(2) NONDISCRIMINATION RULE.—Subsection (a)(7) shall apply in the case of highly compensated employees only if such services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified employer plan.

"(3) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term 'qualified employer plan' means a plan, contract, pension, or account described in section 219(g)(5).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

SEC. 1256. REPORTING SIMPLIFICATION.

(a) SIMPLIFIED ANNUAL FILING REQUIREMENT FOR OWNERS AND THEIR SPOUSES.—

(1) IN GENERAL.—The Secretary of the Treasury shall modify the requirements for filing annual returns with respect to one-participant retirement plans to ensure that such plans with assets of $250,000 or less as of the close of the plan year need not file a return for that year.

(2) ONE-PARTICIPANT RETIREMENT PLAN DEFINED.—For purposes of this subsection, the term "one-participant retirement plan" means a retirement plan that—

(A) on the first day of the plan year—

(i) covered only the employer (and the employer's spouse) and the employer owned the entire business (whether or not incorporated), or

(ii) covered only one or more partners (and their spouses) in a business partnership (including partners in an S or C corporation),

(B) meets the minimum coverage requirements of section 410(b) of the Internal Revenue Code of 1986 without being combined with any other plan of the business that covers the employees of the business,

(C) does not provide benefits to anyone except the employer (and the employer's spouse) or the partners (and their spouses),

(D) does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control, and

(E) does not cover a business that leases employees.

(3) OTHER DEFINITIONS.—Terms used in paragraph (2) which are also used in section 414 of the Internal Revenue Code of 1986 shall have the respective meanings given such terms by such section.

(b) SIMPLIFIED ANNUAL FILING REQUIREMENT FOR PLANS WITH FEWER THAN 25 EMPLOYEES.—In the case of a retirement plan which covers less than 25 employees on the 1st day of the plan year and meets the requirements described in subparagraphs (B), (D), and (E) of subsection (a)(2), the Secretary of the Treasury shall provide for the filing of a simplified annual return that is substantially similar to the annual return required to be filed by a one-participant retirement plan.

(c) EFFECTIVE DATE.—The provisions of this section shall take effect on January 1, 2001.

SEC. 1257. IMPROVEMENT OF EMPLOYEE PLANS COMPLIANCE RESOLUTION SYSTEM.

The Secretary of the Treasury shall continue to update and improve the Employee Plans Compliance Resolution System (or any successor program) giving special attention to—

(1) increasing the awareness and knowledge of small employers concerning the availability and use of the program,

(2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures,

(3) extending the duration of the self-correction period under the Administrative Policy Regarding Self-Correction for significant compliance failures,

(4) expanding the availability to correct insignificant compliance failures under the Administrative Policy Regarding Self-Correction during audit, and

(5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

SEC. 1258. SUBSTANTIAL OWNER BENEFITS IN TERMINATED PLANS.

(a) MODIFICATION OF PHASE-IN OF GUARANTEE.—Section 4022(b)(5) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1322(b)(5)) is amended to read as follows:

"(5)(A) For purposes of this paragraph, the term 'majority owner' means an individual who, at any time during the 60-month period ending on the date the determination is being made—

"(i) owns the entire interest in an unincorporated trade or business,

"(ii) in the case of a partnership, is a partner who owns, directly or indirectly, 50 percent or more of either the capital interest or the profits interest in such partnership, or

"(iii) in the case of a corporation, owns, directly or indirectly, 50 percent or more in value of either the voting stock of that corporation or all the stock of that corporation.

For purposes of clause (iii), the constructive ownership rules of section 1563(e) of the Internal Revenue Code of 1986 shall apply (determined without regard to section 1563(e)(3)(C)).

"(B) In the case of a participant who is a majority owner, the amount of benefits guaranteed under this section shall equal the product of—

"(i) a fraction (not to exceed 1) the numerator of which is the number of years from the later of the effective date or the adoption date of the plan to the termination date, and the denominator of which is 10, and

"(ii) the amount of benefits that would be guaranteed under this section if the participant were not a majority owner.".

(b) MODIFICATION OF ALLOCATION OF ASSETS.—

(1) Section 4044(a)(4)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1344(a)(4)(B)) is amended by striking "section 4022(b)(5)" and inserting "section 4022(b)(5)(B)".

(2) Section 4044(b) of such Act (29 U.S.C. 1344(b)) is amended—

(A) by striking "(5)" in paragraph (2) and inserting "(4), (5),", and

(B) by redesignating paragraphs (3) through (6) as paragraphs (4) through (7), respectively, and by inserting after paragraph (2) the following:

"(3) If assets available for allocation under paragraph (4) of subsection (a) are insufficient to satisfy in full the benefits of all individuals who are described in that paragraph, the assets shall be allocated first to benefits described in subparagraph (A) of that paragraph. Any remaining assets shall then be allocated to benefits described in subparagraph (B) of that paragraph. If assets allocated to such subparagraph (B) are insufficient to satisfy in full the benefits described in that subparagraph, the assets shall be allocated pro rata among individuals on the basis of the present value (as of the termination date) of their respective benefits described in that subparagraph.".

(c) CONFORMING AMENDMENTS.—

(1) Section 4021 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1321) is amended—

(A) in subsection (b)(9), by striking "as defined in section 4022(b)(6)", and

(B) by adding at the end the following:

"(d) For purposes of subsection (b)(9), the term 'substantial owner' means an individual who, at any time during the 60-month period ending on the date the determination is being made—

"(1) owns the entire interest in an unincorporated trade or business,

"(2) in the case of a partnership, is a partner who owns, directly or indirectly, more than 10 percent of either the capital interest or the profits interest in such partnership, or

"(3) in the case of a corporation, owns, directly or indirectly, more than 10 percent in value of either the voting stock of that corporation or all the stock of that corporation.

For purposes of paragraph (3), the constructive ownership rules of section 1563(e) of the Internal Revenue Code of 1986 shall apply (determined without regard to section 1563(e)(3)(C)).".

(2) Section 4043(c)(7) of such Act (29 U.S.C. 1343(c)(7)) is amended by striking "section 4022(b)(6)" and inserting "section 4021(d)".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to plan terminations—

(A) under section 4041(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1341(c)) with respect to which notices of intent to terminate are provided under section 4041(a)(2) of such Act (29 U.S.C. 1341(a)(2)) after December 31, 2000, and

(B) under section 4042 of such Act (29 U.S.C. 1342) with respect to which proceedings are instituted by the corporation after such date.

(2) CONFORMING AMENDMENTS.—The amendments made by subsection (c) shall take effect on the date of enactment of this Act.

SEC. 1259. MODIFICATION OF EXCLUSION FOR EMPLOYER PROVIDED TRANSIT PASSES.

(a) IN GENERAL.—Section 132(f)(3) (relating to cash reimbursements) is amended by striking the last sentence.

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1260. REPEAL OF THE MULTIPLE USE TEST.

(a) IN GENERAL.—Paragraph (9) of section 401(m) is amended to read as follows:

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k), including regulations permitting appropriate aggregation of plans and contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2000.

SEC. 1261. FLEXIBILITY IN NONDISCRIMINATION, COVERAGE, AND LINE OF BUSINESS RULES.

(a) NONDISCRIMINATION.—

(1) IN GENERAL.—The Secretary of the Treasury shall, by regulation, provide that a plan shall be deemed to satisfy the requirements of section 401(a)(4) of the Internal Revenue Code of 1986 if such plan satisfies the facts and circumstances test under section 401(a)(4) of such Code, as in effect before January 1, 1994, but only if—

(A) the plan satisfies conditions prescribed by the Secretary to appropriately limit the availability of such test, and

(B) the plan is submitted to the Secretary for a determination of whether it satisfies such test.

Subparagraph (B) shall only apply to the extent provided by the Secretary.

(2) EFFECTIVE DATES.—

(A) REGULATIONS.—The regulation required by paragraph (1) shall apply to years beginning after December 31, 2000.

(B) CONDITIONS OF AVAILABILITY.—Any condition of availability prescribed by the Secretary under paragraph (1)(A) shall not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

(b) COVERAGE TEST.—

(1) IN GENERAL.—Section 410(b)(1) (relating to minimum coverage requirements) is amended by adding at the end the following:

"(D) In the case that the plan fails to meet the requirements of subparagraphs (A), (B) and (C), the plan—

"(i) satisfies subparagraph (B), as in effect immediately before the enactment of the Tax Reform Act of 1986,

"(ii) is submitted to the Secretary for a determination of whether it satisfies the requirement described in clause (i), and

"(iii) satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of this subparagraph.

Clause (ii) shall apply only to the extent provided by the Secretary.".

(2) EFFECTIVE DATES.—

(A) IN GENERAL.—The amendment made by paragraph (1) shall apply to years beginning after December 31, 2000.

(B) CONDITIONS OF AVAILABILITY.—Any condition of availability prescribed by the Secretary under regulations prescribed by the Secretary under section 410(b)(1)(D) of the Internal Revenue Code of 1986 shall not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

(c) LINE OF BUSINESS RULES.—The Secretary of the Treasury shall, on or before December 31, 2000, modify the existing regulations issued under section 414(r) of the Internal Revenue Code of 1986 in order to expand (to the extent that the Secretary determines appropriate) the ability of a pension plan to demonstrate compliance with the line of business requirements based upon the facts and cir-

cumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

SEC. 1262. EXTENSION TO INTERNATIONAL ORGANIZATIONS OF MORATORIUM ON APPLICATION OF CERTAIN NONDISCRIMINATION RULES APPLICABLE TO STATE AND LOCAL PLANS.

(a) IN GENERAL.—Subparagraph (G) of section 401(a)(5), subparagraph (H) of section 401(a)(26), subparagraph (G) of section 401(k)(3), and paragraph (2) of section 1505(d) of the Taxpayer Relief Act of 1997 are each amended by inserting "or by an international organization which is described in section 414(d)" after "or instrumentality thereof)".

(b) CONFORMING AMENDMENTS.—

(1) The headings for subparagraph (G) of section 401(a)(5) and subparagraph (H) of section 401(a)(26) are each amended by inserting "AND INTERNATIONAL ORGANIZATION" after "GOVERNMENTAL".

(2) Subparagraph (G) of section 401(k)(3) is amended by inserting "STATE AND LOCAL GOVERNMENTAL AND INTERNATIONAL ORGANIZATION PLANS.—" after "(G)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2000.

Subtitle F—Plan Amendments

SEC. 1271. PROVISIONS RELATING TO PLAN AMENDMENTS.

(a) IN GENERAL.—If this section applies to any plan or contract amendment—

(1) such plan or contract shall be treated as being operated in accordance with the terms of the plan during the period described in subsection (b)(2)(A), and

(2) such plan shall not fail to meet the requirements of section 411(d)(6) of the Internal Revenue Code of 1986 by reason of such amendment.

(b) AMENDMENTS TO WHICH SECTION APPLIES.—

(1) IN GENERAL.—This section shall apply to any amendment to any plan or annuity contract which is made—

(A) pursuant to any amendment made by this title, or pursuant to any regulation issued under this title, and

(B) on or before the last day of the first plan year beginning on or after January 1, 2003.

In the case of a government plan (as defined in section 414(d) of the Internal Revenue Code of 1986), this paragraph shall be applied by substituting "2005" for "2003".

(2) CONDITIONS.—This section shall not apply to any amendment unless—

(A) during the period—

(i) beginning on the date the legislative or regulatory amendment described in paragraph (1)(A) takes effect (or in the case of a plan or contract amendment not required by such legislative or regulatory amendment, the effective date specified by the plan), and

(ii) ending on the date described in paragraph (1)(B) (or, if earlier, the date the plan or contract amendment is adopted),

the plan or contract is operated as if such plan or contract amendment were in effect, and

(B) such plan or contract amendment applies retroactively for such period.

TITLE XIII—MISCELLANEOUS PROVISIONS

Subtitle A—Provisions Primarily Affecting Individuals

SEC. 1301. CONSISTENT TREATMENT OF SURVIVOR BENEFITS FOR PUBLIC SAFETY OFFICERS KILLED IN THE LINE OF DUTY.

Subsection (b) of section 1528 of the Taxpayer Relief Act of 1997 (Public Law 105–34) is amended by striking the period and inserting ', and to amounts received in taxable years beginning after December 31, 1999, with respect to individuals dying on or before December 31, 1996.".

SEC. 1302. EXPANSION OF DC HOMEBUYER TAX CREDIT.

(a) EXPANSION OF INCOME LIMITATION.—Section 1400C(b)(1) (relating to limitation based on modified adjusted gross income) is amended—

(1) by striking "$110,000" in subparagraph (A)(i) and inserting "$140,000", and

(2) by inserting "($40,000 in the case of a joint return)" after "$20,000" in subparagraph (B).

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

SEC. 1303. NO FEDERAL INCOME TAX ON AMOUNTS AND LANDS RECEIVED BY HOLOCAUST VICTIMS OR THEIR HEIRS.

(a) IN GENERAL.—For purposes of the Internal Revenue Code of 1986, gross income shall not include—

(1) any amount received by an individual (or any heir of the individual)—

(A) from the Swiss Humanitarian Fund established by the Government of Switzerland or from any similar fund established by any foreign country, or

(B) as a result of the settlement of the action entitled "In re Holocaust Victims' Asset Litigation", (E.D. NY), C.A. No. 96–4849, or as a result of any similar action; and

(2) the value of any land (including structures thereon) recovered by an individual (or any heir of the individual) from a government of a foreign country as a result of a settlement of a claim arising out of the confiscation of such land in connection with the Holocaust.

(b) EFFECTIVE DATE.—This section shall apply to any amount received on or after the date of the enactment of this Act.

Subtitle B—Provisions Primarily Affecting Businesses

SEC. 1311. DISTRIBUTIONS FROM PUBLICLY TRADED PARTNERSHIPS TREATED AS QUALIFYING INCOME OF REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Paragraph (2) of section 851(b) (defining regulated investment company) is amended by inserting "income derived from an interest in a publicly traded partnership (as defined in section 7704(b))," after "dividends, interest,".

(b) SOURCE FLOW-THROUGH RULE NOT TO APPLY.—The last sentence of section 851(b) is amended by inserting "(other than a publicly traded partnership (as defined in section 7704(b)))" after "derived from a partnership".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1312. SPECIAL PASSIVE ACTIVITY RULE FOR PUBLICLY TRADED PARTNERSHIPS TO APPLY TO REGULATED INVESTMENT COMPANIES.

(a) IN GENERAL.—Subsection (k) of section 469 (relating to separate application of section in case of publicly traded partnerships) is amended by adding at the end the following new paragraph:

"(4) APPLICATION TO REGULATED INVESTMENT COMPANIES.—For purposes of this section, a regulated investment company (as defined in section 851) holding an interest in a publicly traded partnership shall be treated as a taxpayer described in subsection (a)(2) with respect to items attributable to such interest.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2000.

SEC. 1313. LARGE ELECTRIC TRUCKS, VANS, AND BUSES ELIGIBLE FOR DEDUCTION FOR CLEAN-FUEL VEHICLES IN LIEU OF CREDIT.

(a) IN GENERAL.—Paragraph (1) of section 30(c) (relating to credit for qualified electric vehicles) is amended by adding at the end the following new flush sentence:

"Such term shall not include any vehicle described in subclause (I) or (II) of section 179A(b)(1)(A)(iii).".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to property placed in service after December 31, 1999.

SEC. 1314. MODIFICATIONS TO SPECIAL RULES FOR NUCLEAR DECOMMISSIONING COSTS.

(a) REPEAL OF LIMITATION ON DEPOSITS INTO FUND BASED ON COST OF SERVICE.—Subsection (b) of section 468A is amended to read as follows:

"(b) LIMITATION ON AMOUNTS PAID INTO FUND.—The amount which a taxpayer may pay into the Fund for any taxable year shall not exceed the ruling amount applicable to such taxable year.".

(b) CLARIFICATION OF TREATMENT OF FUND TRANSFERS.—Subsection (e) of section 468A is amended by adding at the end the following new paragraph:

"(8) TREATMENT OF FUND TRANSFERS.—If, in connection with the transfer of the taxpayer's interest in a nuclear power-

plant, the taxpayer transfers the Fund with respect to such powerplant to the transferee of such interest and the transferee elects to continue the application of this section to such Fund—

"(A) the transfer of such Fund shall not cause such Fund to be disqualified from the application of this section, and

"(B) no amount shall be treated as distributed from such Fund, or be includible in gross income, by reason of such transfer.".

(c) TRANSFERS OF BALANCES IN NONQUALIFIED FUNDS.—Section 468A is amended by redesignating subsections (f) and (g) as subsections (g) and (h), respectively, and by inserting after subsection (e) the following new subsection:

"(f) TRANSFERS OF BALANCES IN NONQUALIFIED FUNDS INTO QUALIFIED FUNDS.—

"(1) IN GENERAL.—Notwithstanding subsection (b), any taxpayer maintaining a Fund to which this section applies with respect to a nuclear powerplant may transfer into such Fund amounts held in any nonqualified fund of such taxpayer with respect to such powerplant.

"(2) MAXIMUM AMOUNT PERMITTED TO BE TRANSFERRED.—The amount permitted to be transferred under paragraph (1) shall not exceed the balance in the nonqualified fund as of December 31, 1998.

"(3) DEDUCTION FOR AMOUNTS TRANSFERRED.—

"(A) IN GENERAL.—The deduction allowed by subsection (a) for any transfer permitted by this subsection shall be allowed ratably over the remaining estimated useful life (within the meaning of subsection (d)(2)(A)) of the nuclear powerplant, beginning with the later of the taxable year during which the transfer is made or the taxpayer's first taxable year beginning after December 31, 2001.

"(B) DENIAL OF DEDUCTION FOR PREVIOUSLY DEDUCTED AMOUNTS.—No deduction shall be allowed for any transfer under this subsection of an amount for which a deduction was allowed when such amount was paid into the nonqualified fund. For purposes of the preceding sentence, a ratable portion of each transfer shall be treated as being from previously deducted amounts to the extent thereof.

"(C) TRANSFERS OF QUALIFIED FUNDS.—If—

"(i) any transfer permitted by this subsection is made to any Fund to which this section applies, and

"(ii) such Fund is transferred thereafter,

any deduction under this subsection for taxable years ending after the date that such Fund is transferred shall be allowed to the transferee and not to the transferor. The preceding sentence shall not apply if the transferor is an organization exempt from tax imposed by this chapter.

"(4) NEW RULING AMOUNT REQUIRED.—Paragraph (1) shall not apply to any transfer unless the taxpayer requests from the Secretary a new schedule of ruling amounts in connection with such transfer.

"(5) NONQUALIFIED FUND.—For purposes of this subsection, the term 'nonqualified fund' means, with respect to any nuclear

powerplant, any fund in which amounts are irrevocably set aside pursuant to the requirements of any State or Federal agency exclusively for the purpose of funding the decommissioning of such powerplant.

"(6) NO BASIS IN QUALIFIED FUNDS.—Notwithstanding any other provision of law, the basis of any Fund to which this section applies shall not be increased by reason of any transfer permitted by this subsection.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1315. CONSOLIDATION OF LIFE INSURANCE COMPANIES WITH OTHER CORPORATIONS.

(a) IN GENERAL.—Section 1504(b) (defining includible corporation) is amended by striking paragraph (2).

(b) CONFORMING AMENDMENTS.—

(1) Subsection (c) of section 1503 is amended by striking paragraph (2) (relating to losses of recent nonlife affiliates).

(2) Section 1504 is amended by striking subsection (c) and by redesignating subsections (d), (e), and (f) as subsections (c), (d), and (e), respectively.

(3) Section 1503(c)(1) (relating to special rule for application of certain losses against income of insurance companies taxed under section 801) is amended by striking "an election under section 1504(c)(2) is in effect for the taxable year and".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) LOSSES OF RECENT NONLIFE AFFILIATES.—The amendment made by subsection (b)(1) shall apply to taxable years beginning after December 31, 2005.

(d) NO CARRYBACK BEFORE JANUARY 1, 2006.—To the extent that a consolidated net operating loss is allowed or increased by reason of the amendments made by this section, such loss may not be carried back to a taxable year beginning before January 1, 2006.

(e) NONTERMINATION OF GROUP.—No affiliated group shall terminate solely as a result of the amendments made by this section.

(f) WAIVER OF 5-YEAR WAITING PERIOD.—Under regulations prescribed by the Secretary of the Treasury or his delegate, an automatic waiver from the 5-year waiting period for reconsolidation provided in section 1504(a)(3) of the Internal Revenue Code of 1986 shall be granted to any corporation which was previously an includible corporation but was subsequently deemed a nonincludible corporation as a result of becoming a subsidiary of a corporation which was not an includible corporation solely by operation of section 1504(c)(2) of such Code (as in effect on the day before the date of the enactment of this Act).

SEC. 1316. MODIFICATION OF ACTIVE BUSINESS DEFINITION UNDER SECTION 355.

(a) IN GENERAL.—Section 355(b) (defining active conduct of a trade or business) is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULES RELATING TO ACTIVE BUSINESS REQUIREMENT.—

"(A) IN GENERAL.—For purposes of determining whether a corporation meets the requirement of paragraph (2)(A), all members of such corporation's separate affiliated group shall be treated as 1 corporation. For purposes of the preceding sentence, a corporation's separate affiliated group is the affiliated group which would be determined under section 1504(a) if such corporation were the common parent and section 1504(b) did not apply.

"(B) CONTROL.—For purposes of paragraph (2)(D), all distributee corporations which are members of the same affiliated group (as defined in section 1504(a) without regard to section 1504(b)) shall be treated as 1 distributee corporation.".

(b) CONFORMING AMENDMENTS.—

(1) Subparagraph (A) of section 355(b)(2) is amended to read as follows:

"(A) it is engaged in the active conduct of a trade or business,".

(2) Section 355(b)(2) is amended by striking the last sentence.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to distributions after the date of the enactment of this Act.

(2) TRANSITION RULE.—The amendments made by this section shall not apply to any distribution pursuant to a transaction which is—

(A) made pursuant to an agreement which was binding on such date and at all times thereafter,

(B) described in a ruling request submitted to the Internal Revenue Service on or before such date, or

(C) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission.

(3) ELECTION TO HAVE AMENDMENTS APPLY.—Paragraph (2) shall not apply if the distributing corporation elects not to have such paragraph apply to distributions of such corporation. Any such election, once made, shall be irrevocable.

SEC. 1317. EXPANSION OF EXEMPTION FROM PERSONAL HOLDING COMPANY TAX FOR LENDING OR FINANCE COMPANIES.

(a) IN GENERAL.—Paragraph (6) of section 542(c) (defining personal holding company) is amended—

(1) by striking "rents," in subparagraph (B), and

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

(3) by striking subparagraph (C), and

(4) by redesignating subparagraph (D) as subparagraph (C).

(b) EXCEPTION FOR LENDING OR FINANCE COMPANIES DETERMINED ON AFFILIATED GROUP BASIS.—Subsection (d) of section 542 is amended by striking paragraphs (1) and (2) and inserting the following new paragraphs:

"(1) LENDING OR FINANCE BUSINESS DEFINED.— For purposes of subsection (c)(6), the term 'lending or finance business' means a 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) rendering services or making facilities available in the ordinary course of a lending or finance business.

"(E) rendering services or making facilities available in connection with activities described in subparagraphs (A), (B), and (C) carried on by the corporation rendering services or making facilities available, or

"(F) rendering services or making facilities available to another corporation which is engaged in the lending or finance business (within the meaning of this paragraph), if such services or facilities are related to the lending or finance business (within such meaning) of such other corporation and such other corporation and the corporation rendering services or making facilities available are members of the same affiliated group (as defined in section 1504).

"(2) EXCEPTION DETERMINED ON AN AFFILIATED GROUP BASIS.—In the case of a lending or finance company which is a member of an affiliated group (as defined in section 1504), such company shall be treated as meeting the requirements of subsection (c)(6) if such group (determined by taking into account only members of such group which are engaged in a lending or finance business) meets such requirements.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after December 31, 1999.

SEC. 1318. EXTENSION OF EXPENSING OF ENVIRONMENTAL REMEDIATION COSTS.

(a) EXPANSION OF QUALIFIED CONTAMINATED SITE.—Section 198(c) is amended to read as follows:

"(c) QUALIFIED CONTAMINATED SITE.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified contaminated site' means any area—

"(A) which is held by the taxpayer for use in a trade or business or for the production of income, or which is property described in section 1221(1) in the hands of the taxpayer, and

"(B) at or on which there has been a release (or threat of release) or disposal of any hazardous substance.

"(2) NATIONAL PRIORITIES LISTED SITES NOT INCLUDED.—Such term shall not include any site which is on, or proposed for, the national priorities list under section 105(a)(8)(B) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (as in effect on the date of the enactment of this section).

"(3) TAXPAYER MUST RECEIVE STATEMENT FROM STATE ENVIRONMENTAL AGENCY.—An area shall be treated as a qualified contaminated site with respect to expenditures paid or incurred during any taxable year only if the taxpayer receives a state-

ment from the appropriate agency of the State in which such area is located that such area meets the requirement of paragraph (1)(B).

"(4) APPROPRIATE STATE AGENCY.—For purposes of paragraph (2), the chief executive officer of each State may, in consultation with the Administrator of the Environmental Protection Agency, designate the appropriate State environmental agency within 60 days of the date of the enactment of this section. If the chief executive officer of a State has not designated an appropriate State environmental agency within such 60-day period, the appropriate environmental agency for such State shall be designated by the Administrator of the Environmental Protection Agency.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to expenditures paid or incurred after December 31, 1999.

Subtitle C—Provisions Relating to Excise Taxes

SEC. 1321. CONSOLIDATION OF HAZARDOUS SUBSTANCE SUPERFUND AND LEAKING UNDERGROUND STORAGE TANK TRUST FUND.

(a) IN GENERAL.—Subchapter A of chapter 98 (relating to trust fund code) is amended by striking sections 9507 and 9508 and inserting the following new section:

"SEC. 9507. ENVIRONMENTAL REMEDIATION TRUST FUND.

"(a) CREATION OF TRUST FUND.—There is established in the Treasury of the United States a trust fund to be known as the 'Environmental Remediation Trust Fund' consisting of such amounts as may be—

"(1) appropriated to the Environmental Remediation Trust Fund as provided in this section,

"(2) appropriated to the Environmental Remediation Trust Fund pursuant to section 517(b) of the Superfund Revenue Act of 1986, or

"(3) credited to the Environmental Remediation Trust Fund as provided in section 9602(b).

"(b) TRANSFERS TO ENVIRONMENTAL REMEDIATION TRUST FUND.—

"(1) IN GENERAL.—There are hereby appropriated to the Environmental Remediation Trust Fund amounts equivalent to—

"(A) the taxes received in the Treasury under—

"(i) section 59A, 4611, 4661, or 4671 (relating to environmental taxes),

"(ii) section 4041(d) (relating to additional taxes on motor fuels),

"(iii) section 4081 (relating to tax on gasoline, diesel fuel, and kerosene) to the extent attributable to the Environmental Remediation Trust Fund financing rate under such section,

"(iv) section 4091 (relating to tax on aviation fuel) to the extent attributable to the Environmental Remedi-

ation Trust Fund financing rate under such section, and

"(v) section 4042 (relating to tax on fuel used in commercial transportation on inland waterways) to the extent attributable to the Environmental Remediation Trust Fund financing rate under such section,

"(B) amounts recovered on behalf of the Environmental Remediation Trust Fund under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (hereinafter in this section referred to as 'CERCLA'),

"(C) all moneys recovered or collected under section 311(b)(6)(B) of the Clean Water Act,

"(D) penalties assessed under title I of CERCLA,

"(E) punitive damages under section 107(c)(3) of CERCLA, and

"(F) amounts received in the Treasury and collected under section 9003(h)(6) of the Solid Waste Disposal Act.

"(2) LIMITATION ON TRANSFERS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no amount may be appropriated or credited to the Environmental Remediation Trust Fund on and after the date of any expenditure from any such Trust Fund which is not permitted by this section. The determination of whether an expenditure is so permitted shall be made without regard to—

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

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

"(B) EXCEPTION FOR PRIOR OBLIGATIONS.—Subparagraph (A) shall not apply to any expenditure to liquidate any contract entered into (or for any amount otherwise obligated) in accordance with the provisions of this section.".

"(c) EXPENDITURES FROM ENVIRONMENTAL REMEDIATION TRUST FUND.—

"(1) IN GENERAL.—Amounts in the Environmental Remediation Trust Fund shall be available, as provided in appropriation Acts, only for purposes of making expenditures—

"(A) to carry out the purposes of—

"(i) paragraphs (1), (2), (5), and (6) of section 111(a) of CERCLA as in effect on July 12, 1999,

"(ii) section 111(c) of CERCLA (as so in effect), other than paragraphs (1) and (2) thereof, and

"(iii) section 111(m) of CERCLA (as so in effect), or

"(B) to carry out section 9003(h) of the Solid Waste Disposal Act as in effect on July 12, 1999.

"(2) EXCEPTION FOR CERTAIN TRANSFERS, ETC., OF HAZARDOUS SUBSTANCES.—No amount in the Environmental Remediation Trust Fund or derived from the Environmental Remediation Trust Fund shall be available or used for the transfer or disposal of hazardous waste carried out pursuant to a cooperative agreement between the Administrator of the Environmental

Protection Agency and a State if the following conditions apply—

"(A) the transfer or disposal, if made on December 13, 1985, would not comply with a State or local requirement,

"(B) the transfer is to a facility for which a final permit under section 3005(a) of the Solid Waste Disposal Act was issued after January 1, 1983, and before November 1, 1984, and

"(C) the transfer is from a facility identified as the McColl Site in Fullerton, California.

"(3) TRANSFERS FROM TRUST FUND FOR CERTAIN REPAYMENTS AND CREDITS.—

"(A) IN GENERAL.—The Secretary shall pay from time to time from the Environmental Remediation Trust Fund into the general fund of the Treasury amounts equivalent to—

"(i) amounts paid under—

"(I) section 6420 (relating to amounts paid in respect of gasoline used on farms),

"(II) section 6421 (relating to amounts paid in respect of gasoline used for certain nonhighway purposes or by local transit systems), and

"(III) section 6427 (relating to fuels not used for taxable purposes), and

"(ii) credits allowed under section 34,

with respect to the taxes imposed by section 4041(d) or by sections 4081 and 4091 (to the extent attributable to the Leaking Underground Storage Tank Trust Fund financing rate or the Environmental Remediation Trust Fund financing rate under such sections).

"(B) TRANSFERS BASED ON ESTIMATES.—Transfers under subparagraph (A) shall be made on the basis of estimates by the Secretary, and proper adjustments shall be made in amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred.

"(d) LIABILITY OF UNITED STATES LIMITED TO AMOUNT IN TRUST FUND.—

"(1) GENERAL RULE.—Any claim filed against the Environmental Remediation Trust Fund may be paid only out of the Environmental Remediation Trust Fund.

"(2) COORDINATION WITH OTHER PROVISIONS.—Nothing in CERCLA or the Superfund Amendments and Reauthorization Act of 1986 (or in any amendment made by either of such Acts) shall authorize the payment by the United States Government of any amount with respect to any such claim out of any source other than the Environmental Remediation Trust Fund.

"(3) ORDER IN WHICH UNPAID CLAIMS ARE TO BE PAID.—If at any time the Environmental Remediation Trust Fund has insufficient funds to pay all of the claims payable out of the Environmental Remediation Trust Fund at such time, such claims shall, to the extent permitted under paragraph (1), be paid in full in the order in which they were finally determined.

"(e) SEPARATE ACCOUNTING IF SUPERFUND REAUTHORIZED.—

"(1) IN GENERAL.—If a Federal law is enacted after September 30, 1999, which authorizes expenditures out of the Environmental Remediation Trust Fund for purposes of carrying out provisions of CERCLA not described in subsection (c)(1)(A), this section shall be applied as if such Fund consisted of 2 accounts: a Superfund Account and a Leaking Underground Storage Tank Account.

"(2) AMOUNTS IN ACCOUNTS.—

"(A) LEAKING UNDERGROUND STORAGE TANK ACCOUNT.—The Leaking Underground Storage Tank Account—

"(i) shall consist of amounts which would have been appropriated or credited to the Leaking Underground Storage Tank Trust Fund but for the amendments made by section 1321 of the Taxpayer Refund and Relief Act of 1999, and

"(ii) shall be available, as provided in appropriation Acts, for the purposes for which the Leaking Underground Storage Tank Trust Fund was available (as in effect on the day before the date of the enactment of such amendments).

"(B) SUPERFUND ACCOUNT.—The Superfund Account—

"(i) shall consist of amounts which would have been appropriated or credited to the Hazardous Substance Superfund but for such amendments, and

"(ii) shall be available, as provided in appropriation Acts, for the purposes for which the Hazardous Substance Superfund was available (as so in effect).

"(3) OPENING BALANCES.—

"(A) LEAKING UNDERGROUND STORAGE TANK ACCOUNT.—The balance in the Leaking Underground Storage Tank Account as of the date of the enactment of the Federal law referred to in paragraph (1) shall be the sum of—

"(i) the amount which bears the same ratio to the balance in such Trust Fund as of such date, bears to the sum of the balances (as of the close of September 30, 1999) in Leaking Underground Storage Tank Trust Fund and the Hazardous Substance Superfund, and

"(ii) the aggregate amount appropriated to the Environmental Remediation Trust Fund after September 30, 1999, by reason of taxes received in the Treasury.

"(B) SUPERFUND ACCOUNT.—The balance in the Superfund Account as of the date of the enactment of the Federal law referred to in paragraph (1) shall be the excess of the balance in such Trust Fund as of such date over the balance of the Leaking Underground Storage Tank Account determined under subparagraph (A).

"(4) SPECIAL TRANSFER RULE.—If the balance in the Environmental Remediation Trust Fund as of the date of the enactment of the Federal law referred to in paragraph (1) is less than the required balance for the Leaking Underground Storage Tank Account, amounts otherwise required to be deposited in the Superfund Account shall be reduced (to the extent of the

shortfall) and deposited into the Leaking Underground Storage Tank Account.".

(b) CONFORMING AMENDMENTS.—

(1) Subsections (c) and (e) of section 4611 are each amended by striking "Hazardous Substance Superfund" each place it appears and inserting "Environmental Remediation Trust Fund".

(2) Subsection (c) of section 4661 is amended by striking "Hazardous Substance Superfund" and inserting "Environmental Remediation Trust Fund".

(3) Sections 4041(d), 4042(b), 4081(a)(2)(B), 4081(d)(3), 4091(b), 4092(b), 6421(f), and 6427(l) are each amended by striking "Leaking Underground Storage Tank" each place it appears (other than the headings) and inserting "Environmental Remediation".

(4) The heading for subsection (d) of section 4041 is amended by striking "LEAKING UNDERGROUND STORAGE TANK" and inserting "ENVIRONMENTAL REMEDIATION".

(5) The headings for subsections (a)(2)(B) and (d)(3) of section 4081 and section 4091(b)(2) are each amended by striking "LEAKING UNDERGROUND STORAGE TANK" and inserting "ENVIRONMENTAL REMEDIATION".

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

(d) ENVIRONMENTAL REMEDIATION TRUST FUND TREATED AS CONTINUATION OF OLD TRUST FUNDS.—The Environmental Remediation Trust Fund established by the amendments made by this section shall be treated for all purposes of law as a continuation of both the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund. Any reference in any law to the Hazardous Substance Superfund or the Leaking Underground Storage Tank Trust Fund shall be deemed to include (wherever appropriate) a reference to the Environmental Remediation Trust Fund established by such amendments.

SEC. 1322. REPEAL OF CERTAIN MOTOR FUEL EXCISE TAXES ON FUEL USED BY RAILROADS AND ON INLAND WATERWAY TRANSPORTATION.

(a) REPEAL OF LEAKING UNDERGROUND STORAGE TANK TRUST FUND TAXES ON FUEL USED IN TRAINS.—

(1) IN GENERAL.—Paragraph (1) of section 4041(d) is amended by adding at the end the following new sentence: "The preceding sentence shall not apply to any sale for use, or use, of fuel in a diesel-powered train.".

(2) CONFORMING AMENDMENTS.—

(A) Paragraph (3) of section 6421(f) is amended by striking "with respect to—" and all that follows through "so much of" and inserting "with respect to so much of".

(B) Paragraph (3) of section 6427(l) is amended by striking "with respect to—" and all that follows through "so much of" and inserting "with respect to so much of".

(b) REPEAL OF 4.3-CENT MOTOR FUEL EXCISE TAXES ON RAILROADS AND INLAND WATERWAY TRANSPORTATION WHICH REMAIN IN GENERAL FUND.—

(1) TAXES ON TRAINS.—

(A) IN GENERAL.—Subparagraph (A) of section 4041(a)(1) is amended by striking "or a diesel-powered train" each place it appears and by striking "or train".

(B) CONFORMING AMENDMENTS.—

(i) Subparagraph (C) of section 4041(a)(1) is amended by striking clause (ii) and by redesignating clause (iii) as clause (ii).

(ii) Subparagraph (C) of section 4041(b)(1) is amended by striking all that follows "section 6421(e)(2)" and inserting a period.

(iii) Paragraph (3) of section 4083(a) is amended by striking "or a diesel-powered train".

(iv) Section 6421(f) is amended by striking paragraph (3).

(v) Section 6427(l) is amended by striking paragraph (3).

(2) FUEL USED ON INLAND WATERWAYS.—

(A) IN GENERAL.—Paragraph (1) of section 4042(b) is amended by adding "and" at the end of subparagraph (A), by striking ", and" at the end of subparagraph (B) and inserting a period, and by striking subparagraph (C).

(B) CONFORMING AMENDMENT.—Paragraph (2) of section 4042(b) is amended by striking subparagraph (C).

(c) EFFECTIVE DATE.—The amendments made by this subsection shall take effect on October 1, 1999 (October 1, 2003, in the case of the amendments made by subsection (b)), but shall not take effect if section 1321 does not take effect.

SEC. 1323. REPEAL OF EXCISE TAX ON FISHING TACKLE BOXES.

(a) REPEAL.—Paragraph (6) of section 4162(a) (defining sport fishing equipment) is amended by striking subparagraph (C) and by redesignating subparagraphs (D) through (J) as subparagraphs (C) through (I), respectively.

(b) MODIFICATION OF TRANSFER TO AQUATIC RESOURCES TRUST FUND.—Section 9503(b)(4)(D) is amended—

(1) by striking "11.5 cents" in clause (i) and inserting "11.7 cents",

(2) by striking "13 cents" in clause (ii) and inserting "13.2 cents", and

(3) by striking "13.5 cents" in clause (iii) and inserting "13.7 cents".

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect 30 days after the date of the enactment of this Act.

SEC. 1324. CLARIFICATION OF EXCISE TAX IMPOSED ON ARROW COMPONENTS.

(a) IN GENERAL.—Paragraph (2) of section 4161(b) (relating to bows and arrows, etc.) is amended to read as follows:

"(2) ARROWS.—

"(A) IN GENERAL.—There is hereby imposed on the sale by the manufacturer, producer, or importer of any shaft, point, article used to attach a point to a shaft, nock, or vane of a type used in the manufacture of any arrow which after its assembly—

"(i) measures 18 inches overall or more in length, or

"(ii) measures less than 18 inches overall in length but is suitable for use with a bow described in paragraph (1)(A),

a tax equal to 12.4 percent of the price for which so sold.

"(B) REDUCED RATE ON CERTAIN HUNTING POINTS.—Subparagraph (A) shall be applied by substituting '11 percent' for '12.4 percent' in the case of a point which is designed primarily for use in hunting fish or large animals.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to articles sold by the manufacturer, producer, or importer after the close of the first calendar month ending more than 30 days after the date of the enactment of this Act.

SEC. 1325. EXEMPTION FROM TICKET TAXES FOR CERTAIN TRANSPORTATION PROVIDED BY SMALL SEAPLANES.

(a) IN GENERAL.—Section 4281 (relating to small aircraft on nonestablished lines) is amended to read as follows:

"SEC. 4281. SMALL AIRCRAFT.

"The taxes imposed by sections 4261 and 4271 shall not apply to—

"(1) transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less, except when such aircraft is operated on an established line, and

"(2) transportation by a seaplane having a maximum certificated takeoff weight of 6,000 pounds or less with respect to any segment consisting of a takeoff from, and a landing on, water.

For purposes of the preceding sentence, the term 'maximum certificated takeoff weight' means the maximum such weight contained in the type certificate or airworthiness certificate.".

(b) CLERICAL AMENDMENT.—The table of sections for part III of subchapter C of chapter 33 is amended by striking "on nonestablished lines" in the item relating to section 4281.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid for transportation beginning after December 31, 1999, but shall not apply to any amount paid on or before such date with respect to taxes imposed by sections 4261 and 4271 of the Internal Revenue Code of 1986.

SEC. 1326. MODIFICATION OF RURAL AIRPORT DEFINITION.

(a) IN GENERAL.—Clause (ii) of section 4261(e)(1)(B) (defining rural airport) is amended by striking the period at the end of subclause (II) and inserting ", or", and by adding at the end the following new subclause:

"(III) is not connected by paved roads to another airport.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years beginning after 1999.

Subtitle D—Other Provisions

SEC. 1331. TAX-EXEMPT FINANCING OF QUALIFIED HIGHWAY INFRASTRUCTURE CONSTRUCTION.

(a) TREATMENT AS EXEMPT FACILITY BOND.—A bond described in subsection (b) shall be treated as described in section 141(e)(1)(A) of the Internal Revenue Code of 1986, except that—

(1) section 146 of such Code shall not apply to such bond, and

(2) section 147(c)(1) of such Code shall be applied by substituting "any portion of" for "25 percent or more".

(b) BOND DESCRIBED.—

(1) IN GENERAL.—A bond is described in this subsection if such bond is issued after December 31, 1999, as part of an issue—

(A) 95 percent or more of the net proceeds of which are to be used to provide a qualified highway infrastructure project, and

(B) to which there has been allocated a portion of the allocation to the project under paragraph (2)(C)(ii) which is equal to the aggregate face amount of bonds to be issued as part of such issue.

(2) QUALIFIED HIGHWAY INFRASTRUCTURE PROJECTS.—

(A) IN GENERAL.—For purposes of paragraph (1), the term "qualified highway infrastructure project" means a project—

(i) for the construction or reconstruction of a highway, and

(ii) designated under subparagraph (B) as an eligible pilot project.

(B) ELIGIBLE PILOT PROJECT.—

(i) IN GENERAL.—The Secretary of Transportation, in consultation with the Secretary of the Treasury, shall select not more than 15 highway infrastructure projects to be pilot projects eligible for tax-exempt financing.

(ii) ELIGIBILITY CRITERIA.—In determining the criteria necessary for the eligibility of pilot projects, the Secretary of Transportation shall include the following:

(I) The project must serve the general public.

(II) The project is necessary to evaluate the potential of the private sector's participation in the provision of the highway infrastructure of the United States.

(III) The project must be located on publicly-owned rights-of-way.

(IV) The project must be publicly owned or the ownership of the highway constructed or reconstructed under the project must revert to the public.

(V) The project must be consistent with a transportation plan developed pursuant to section 134(g) or 135(e) of title 23, United States Code.

(C) AGGREGATE FACE AMOUNT OF TAX-EXEMPT FINANCING.—

(i) IN GENERAL.—The aggregate face amount of bonds issued pursuant to this section shall not exceed $15,000,000,000, determined without regard to any bond the proceeds of which are used exclusively to refund (other than to advance refund) a bond issued pursuant to this section (or a bond which is a part of a series of refundings of a bond so issued) if the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(ii) ALLOCATION.—The Secretary of Transportation, in consultation with the Secretary of the Treasury, shall allocate the amount described in clause (i) among the eligible pilot projects designated under subparagraph (B).

(iii) REALLOCATION.—If any portion of an allocation under clause (ii) is unused on the date which is 3 years after such allocation, the Secretary of Transportation, in consultation with the Secretary of the Treasury, may reallocate such portion among the remaining eligible pilot projects.

SEC. 1332. TAX TREATMENT OF ALASKA NATIVE SETTLEMENT TRUSTS.

(a) IN GENERAL.—Subpart A of part I of subchapter J of chapter 1 (relating to general rules for taxation of trusts and estates) is amended by adding at the end the following new section:

"SEC. 646. ELECTING ALASKA NATIVE SETTLEMENT TRUSTS.

"(a) IN GENERAL.—Except as otherwise provided in this section, the provisions of this subchapter and section 1(e) shall apply to all Settlement Trusts.

"(b) BENEFICIARIES OF ELECTING TRUST NOT TAXED ON CONTRIBUTIONS.—

"(1) IN GENERAL.—In the case of a Settlement Trust for which an election under paragraph (2) is in effect for any taxable year, no amount shall be includible in the gross income of a beneficiary of the Settlement Trust by reason of a contribution to the Settlement Trust made during such taxable year.

"(2) ONE-TIME ELECTION.—

"(A) IN GENERAL.—A Settlement Trust may elect to have the provisions of this section apply to the trust and its beneficiaries.

"(B) TIME AND METHOD OF ELECTION.—An election under subparagraph (A) shall be made—

"(i) on or before the due date (including extensions) for filing the Settlement Trust's return of tax for the 1st taxable year of the Settlement Trust ending after December 31, 1999, and

"(ii) by attaching to such return of tax a statement specifically providing for such election.

"(C) PERIOD ELECTION IN EFFECT.—Except as provided in paragraph (3), an election under subparagraph (A)—

"(i) shall apply to the 1st taxable year described in subparagraph (B)(i) and all subsequent taxable years, and

"(ii) may not be revoked once it is made.

"(c) SPECIAL RULES WHERE TRANSFER RESTRICTIONS MODIFIED.—

"(1) TRANSFER OF BENEFICIAL INTERESTS.—If, at any time, a beneficial interest in a Settlement Trust may be disposed of to a person in a manner which would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)) if the interest were Settlement Common Stock—

"(A) no election may be made under subsection (b)(2) with respect to such trust, and

"(B) if such an election is in effect as of such time, such election shall cease to apply for purposes of subsection (b)(1) as of the 1st day of the taxable year following the taxable year in which such disposition is first permitted.

"(2) STOCK IN CORPORATION.—If—

"(A) the Settlement Common Stock in any Native Corporation which transferred assets to a Settlement Trust making an election under subsection (b)(2) may be disposed of to a person in a manner not permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)), and

"(B) at any time after such disposition of stock is first permitted, such corporation transfers assets to such trust,

subparagraph (B) of paragraph (1) shall be applied to such trust on and after the date of the transfer in the same manner as if the trust permitted dispositions of beneficial interests in the trust in a manner not permitted by such section 7(h).

"(c) TAX TREATMENT OF DISTRIBUTIONS TO BENEFICIARIES.—

"(1) IN GENERAL.—In the case of a Settlement Trust for which an election under subsection (b)(2) is in effect for any taxable year, any distribution to a beneficiary shall be included in gross income of the beneficiary as ordinary income to the extent such distribution reduces the earnings and profits of any Native Corporation making a contribution to such Trust.

"(2) EARNINGS AND PROFITS.—The earnings and profits of any Native Corporation making a contribution to a Settlement Trust shall not be reduced on account thereof at the time of such contribution, but such earnings and profits shall be reduced (up to the amount of such contribution) as distributions are thereafter made by the Settlement Trust which exceed the sum of—

"(A) such Trust's total undistributed net income for all prior years during which an election under subsection (b)(2) is in effect, and

"(B) such Trust's distributable net income.

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

"(1) NATIVE CORPORATION.—The term 'Native Corporation' has the meaning given such term by section 3(m) of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)).

"(2) SETTLEMENT TRUST.—The term 'Settlement Trust' means a trust which constitutes a Settlement Trust under sec-

tion 39 of the Alaska Native Claims Settlement Act (43 U.S.C. 1629e).".

(b) WITHHOLDING ON DISTRIBUTIONS BY ELECTING ANCSA SETTLEMENT TRUSTS.—Section 3402 is amended by adding at the end the following new subsection:

"(t) TAX WITHHOLDING ON DISTRIBUTIONS BY ELECTING ANCSA SETTLEMENT TRUSTS.—

"(1) IN GENERAL.—Any Settlement Trust (as defined in section 646(d)) for which an election under section 646(b)(2) is in effect (in this subsection referred to as an 'electing trust') and which makes a payment to any beneficiary which is includable in gross income under section 646(c) shall deduct and withhold from such payment a tax in an amount equal to such payment's proportionate share of the annualized tax.

"(2) EXCEPTION.—The tax imposed by paragraph (1) shall not apply to any payment to the extent that such payment, when annualized, does not exceed an amount equal to the amount in effect under section 6012(a)(1)(A)(i) for taxable years beginning in the calendar year in which the payment is made.

"(3) ANNUALIZED TAX.—For purposes of paragraph (1), the term 'annualized tax' means, with respect to any payment, the amount of tax which would be imposed by section 1(c) (determined without regard to any rate of tax in excess of 31 percent) on an amount of taxable income equal to the excess of—

"(A) the annualized amount of such payment, over

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

"(4) ANNUALIZATION.—For purposes of this subsection, amounts shall be annualized in the manner prescribed by the Secretary.

"(5) ALTERNATE WITHHOLDING PROCEDURES.—At the election of an electing trust, the tax imposed by this subsection on any payment made by such trust shall be determined in accordance with such tables or computational procedures as may be specified in regulations prescribed by the Secretary (in lieu of in accordance with paragraphs (2) and (3)).

"(6) COORDINATION WITH OTHER SECTIONS.—For purposes of this chapter and so much of subtitle F as relates to this chapter, payments which are subject to withholding under this subsection shall be treated as if they were wages paid by an employer to an employee.".

(c) REPORTING.—Section 6041 is amended by adding at the end the following new subsection:

"(f) APPLICATION TO ALASKA NATIVE SETTLEMENT TRUSTS.—In the case of any distribution from a Settlement Trust (as defined in section 646(d)) to a beneficiary which is includable in gross income under section 646(c), this section shall apply, except that—

"(1) this section shall apply to such distribution without regard to the amount thereof,

"(2) the Settlement Trust shall include on any return or statement required by this section information as to the character of such distribution (if applicable) and the amount of tax imposed by chapter 1 which has been deducted and withheld from such distribution, and

"(3) the filing of any return or statement required by this section shall satisfy any requirement to file any other form or schedule under this title with respect to distributive share information (including any form or schedule to be included with the trust's tax return).".

(d) CLERICAL AMENDMENT.—The table of sections for subpart A of part I of subchapter J of chapter 1 is amended by adding at the end the following new item:

"Sec. 646. Electing Alaska Native Settlement Trusts.".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of Settlement Trusts ending after December 31, 1999, and to contributions to such trusts after such date.

SEC. 1333. INCREASE IN THRESHOLD FOR JOINT COMMITTEE REPORTS ON REFUNDS AND CREDITS.

(a) GENERAL RULE.—Subsections (a) and (b) of section 6405 are each amended by striking "$1,000,000" and inserting "$2,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act, except that such amendment shall not apply with respect to any refund or credit with respect to a report that has been made before such date of the enactment under section 6405 of the Internal Revenue Code of 1986.

SEC. 1334. CREDIT FOR CLINICAL TESTING RESEARCH EXPENSES ATTRIBUTABLE TO CERTAIN QUALIFIED ACADEMIC INSTITUTIONS INCLUDING TEACHING HOSPITALS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 (relating to business related credits) is amended by inserting after section 41 the following:

"SEC. 41A. CREDIT FOR MEDICAL INNOVATION EXPENSES.

"(a) GENERAL RULE.—For purposes of section 38, the medical innovation credit determined under this section for the taxable year shall be an amount equal to 40 percent of the excess (if any) of—

"(1) the qualified medical innovation expenses for the taxable year, over

"(2) the medical innovation base period amount.

"(b) QUALIFIED MEDICAL INNOVATION EXPENSES.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified medical innovation expenses' means the amounts which are paid or incurred by the taxpayer during the taxable year directly or indirectly to any qualified academic institution for clinical testing research activities.

"(2) CLINICAL TESTING RESEARCH ACTIVITIES.—

"(A) IN GENERAL.—The term 'clinical testing research activities' means human clinical testing conducted at any qualified academic institution in the development of any product, which occurs before—

"(i) the date on which an application with respect to such product is approved under section 505(b), 506, or 507 of the Federal Food, Drug, and Cosmetic Act (as in effect on the date of the enactment of this section),

"(ii) the date on which a license for such product is issued under section 351 of the Public Health Service Act (as so in effect), or

"(iii) the date classification or approval of such product which is a device intended for human use is given under section 513, 514, or 515 of the Federal Food, Drug, and Cosmetic Act (as so in effect).

"(B) PRODUCT.—The term 'product' means any drug, biologic, or medical device.

"(3) QUALIFIED ACADEMIC INSTITUTION.—The term 'qualified academic institution' means any of the following institutions:

"(A) EDUCATIONAL INSTITUTION.—A qualified organization described in section 170(b)(1)(A)(iii) which is owned by, or affiliated with, an institution of higher education (as defined in section 3304(f)).

"(B) TEACHING HOSPITAL.—A teaching hospital which—

"(i) is publicly supported or owned by an organization described in section 501(c)(3), and

"(ii) is affiliated with an organization meeting the requirements of subparagraph (A).

"(C) FOUNDATION.—A medical research organization described in section 501(c)(3) (other than a private foundation) which is affiliated with, or owned by—

"(i) an organization meeting the requirements of subparagraph (A), or

"(ii) a teaching hospital meeting the requirements of subparagraph (B).

"(D) CHARITABLE RESEARCH HOSPITAL.—A hospital that is designated as a cancer center by the National Cancer Institute.

"(4) EXCLUSION FOR AMOUNTS FUNDED BY GRANTS, ETC.—The term 'qualified medical innovation expenses' shall not include any amount to the extent such amount is funded by any grant, contract, or otherwise by another person (or any governmental entity).

"(c) MEDICAL INNOVATION BASE PERIOD AMOUNT.—For purposes of this section, the term 'medical innovation base period amount' means the average annual qualified medical innovation expenses paid by the taxpayer during the 3-taxable year period ending with the taxable year immediately preceding the first taxable year of the taxpayer beginning after December 31, 1998.

"(d) SPECIAL RULES.—

"(1) LIMITATION ON FOREIGN TESTING.—No credit shall be allowed under this section with respect to any clinical testing research activities conducted outside the United States.

"(2) CERTAIN RULES MADE APPLICABLE.—Rules similar to the rules of subsections (f) and (g) of section 41 shall apply for purposes of this section.

"(3) ELECTION.—This section shall apply to any taxpayer for any taxable year only if such taxpayer elects to have this section apply for such taxable year.

"(4) COORDINATION WITH CREDIT FOR INCREASING RESEARCH EXPENDITURES AND WITH CREDIT FOR CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS FOR RARE DISEASES.—Any qualified medical innovation expense for a taxable year to which an election under this section applies shall not be taken into account for purposes of determining the credit allowable under section 41 or 45C for such taxable year.".

(b) CREDIT TO BE PART OF GENERAL BUSINESS CREDIT.—

(1) IN GENERAL.—Section 38(b) (relating to current year business credits) is amended by striking "plus" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting ", plus", and by adding at the end the following:

"(13) the medical innovation expenses credit determined under section 41A(a).".

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

"(9) NO CARRYBACK OF SECTION 41A CREDIT BEFORE ENACTMENT.—No portion of the unused business credit for any taxable year which is attributable to the medical innovation credit determined under section 41A may be carried back to a taxable year beginning before January 1, 1999.".

(c) DENIAL OF DOUBLE BENEFIT.—Section 280C is amended by adding at the end the following new subsection:

"(d) CREDIT FOR INCREASING MEDICAL INNOVATION EXPENSES.—

"(1) IN GENERAL.—No deduction shall be allowed for that portion of the qualified medical innovation expenses (as defined in section 41A(b)) otherwise allowable as a deduction for the taxable year which is equal to the amount of the credit determined for such taxable year under section 41A(a).

"(2) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (2), (3), and (4) of subsection (c) shall apply for purposes of this subsection.".

(d) DEDUCTION FOR UNUSED PORTION OF CREDIT.—Section 196(c) (defining qualified business credits) is amended by redesignating paragraphs (5) through (8) as paragraphs (6) through (9), respectively, and by inserting after paragraph (4) the following new paragraph:

"(5) the medical innovation expenses credit determined under section 41A(a) (other than such credit determined under the rules of section 280C(d)(2)),".

(e) CLERICAL AMENDMENT.—The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding after the item relating to section 41 the following:

"Sec. 41A. Credit for medical innovation expenses.".

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

SEC. 1335. PAYMENT OF DIVIDENDS ON STOCK OF COOPERATIVES WITHOUT REDUCING PATRONAGE DIVIDENDS.

(a) IN GENERAL.—Subsection (a) of section 1388 (relating to patronage dividend defined) is amended by adding at the end the following: "For purposes of paragraph (3), net earnings shall not be reduced by amounts paid during the year as dividends on capital

stock or other proprietary capital interests of the organization to the extent that the articles of incorporation or bylaws of such organization or other contract with patrons provide that such dividends are in addition to amounts otherwise payable to patrons which are derived from business done with or for patrons during the taxable year.".

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

Subtitle E—Tax Court Provisions

SEC. 1341. TAX COURT FILING FEE IN ALL CASES COMMENCED BY FILING PETITION.

(a) IN GENERAL.—Section 7451 (relating to fee for filing a Tax Court petition) is amended by striking all that follows "petition" and inserting a period.

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1342. EXPANDED USE OF TAX COURT PRACTICE FEE.

Subsection (b) of section 7475 (relating to use of fees) is amended by inserting before the period at the end "and to provide services to pro se taxpayers".

SEC. 1343. CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.

(a) CONFIRMATION OF AUTHORITY OF TAX COURT TO APPLY DOCTRINE OF EQUITABLE RECOUPMENT.—Subsection (b) of section 6214 (relating to jurisdiction over other years and quarters) is amended by adding at the end the following new sentence: "Notwithstanding the preceding sentence, the Tax Court may apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases before the district courts of the United States and the United States Court of Federal Claims.".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to any action or proceeding in the Tax Court with respect to which a decision has not become final (as determined under section 7481 of the Internal Revenue Code of 1986) as of the date of the enactment of this Act.

TITLE XIV—EXTENSIONS OF EXPIRING PROVISIONS

SEC. 1401. RESEARCH CREDIT.

(a) EXTENSION.—

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

(A) by striking "June 30, 1999" and inserting "June 30, 2004", and

(B) by striking the material following subparagraph (B).

(2) TECHNICAL AMENDMENT.—Subparagraph (D) of section 45C(b)(1) is amended by striking "June 30, 1999" and inserting "June 30, 2004".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to amounts paid or incurred after June 30, 1999.

(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, 1999.

SEC. 1402. SUBPART F EXEMPTION FOR ACTIVE FINANCING INCOME.

(a) IN GENERAL.—Sections 953(e)(10) and 954(h)(9) are each amended—

(1) by striking "the first taxable year" and inserting "taxable years", and

(2) by striking "January 1, 2000" and inserting "January 1, 2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1403. TAXABLE INCOME LIMIT ON PERCENTAGE DEPLETION FOR MARGINAL PRODUCTION.

(a) IN GENERAL.—Subparagraph (H) of section 613A(c)(6) is amended by striking "January 1, 2000" and inserting "January 1, 2005".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1999.

SEC. 1404. WORK OPPORTUNITY CREDIT AND WELFARE-TO-WORK CREDIT.

(a) TEMPORARY EXTENSION.—Sections 51(c)(4)(B) and 51A(f) (relating to termination) are each amended by striking "June 30, 1999" and inserting "December 31, 2001".

(b) CLARIFICATION OF FIRST YEAR OF EMPLOYMENT.—Paragraph (2) of section 51(i) is amended by striking "during which he was not a member of a targeted group".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to individuals who begin work for the employer after June 30, 1999.

SEC. 1405. EXTENSION AND MODIFICATION OF CREDIT FOR PRODUCING ELECTRICITY FROM CERTAIN RENEWABLE RESOURCES.

(a) EXTENSION AND MODIFICATION OF PLACED-IN-SERVICE RULES.—Paragraph (3) of section 45(c) is amended to read as follows:

"(3) QUALIFIED FACILITY.—

"(A) WIND FACILITY.—In the case of a facility using wind to produce electricity, the term 'qualified facility' means any facility owned by the taxpayer which is originally placed in service after December 31, 1993, and before July 1, 2003.

"(B) CLOSED-LOOP BIOMASS FACILITY.—In the case of a facility using closed-loop biomass to produce electricity, the term 'qualified facility' means any facility owned by the taxpayer which is originally placed in service after December 31, 1992, and before July 1, 2003.

"(C) POULTRY WASTE FACILITY.—In the case of a facility using poultry waste to produce electricity, the term 'qualified facility' means any facility of the taxpayer which is originally placed in service after December 31, 1999, and before July 1, 2003.".

(b) EXPANSION OF QUALIFIED ENERGY RESOURCES.—

(1) IN GENERAL.—Section 45(c)(1) (defining qualified energy resources) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by adding at the end the following new subparagraph:

"(C) poultry waste.".

(2) DEFINITION.—Section 45(c) is amended by adding at the end the following new paragraph:

"(4) POULTRY WASTE.—The term 'poultry waste' means poultry manure and litter, including wood shavings, straw, rice hulls, and other bedding material for the disposition of manure.".

(c) SPECIAL RULES.—Section 45(d) (relating to definitions and special rules) is amended by adding at the end the following new paragraphs:

"(6) CREDIT ELIGIBILITY IN THE CASE OF GOVERNMENT-OWNED FACILITIES USING POULTRY WASTE.—In the case of a facility using poultry waste to produce electricity and owned by a governmental unit, the person eligible for the credit under subsection (a) is the lessor or the operator of such facility.

"(7) CREDIT NOT TO APPLY TO ELECTRICITY SOLD TO UTILITIES UNDER CERTAIN CONTRACTS.—

"(A) IN GENERAL.—The credit determined under subsection (a) shall not apply to electricity—

"(i) produced at a qualified facility described in paragraph (3)(A) which is placed in service by the taxpayer after June 30, 1999, and

"(ii) sold to a utility pursuant to a contract originally entered into before January 1, 1987 (whether or not amended or restated after that date).

"(B) EXCEPTION.—Subparagraph (A) shall not apply if—

"(i) the prices for energy and capacity from such facility are established pursuant to an amendment to the contract referred to in subparagraph (A)(ii);

"(ii) such amendment provides that the prices set forth in the contract which exceed avoided cost prices determined at the time of delivery shall apply only to

annual quantities of electricity (prorated for partial years) which do not exceed the greater of—

"(I) the average annual quantity of electricity sold to the utility under the contract during calendar years 1994, 1995, 1996, 1997, and 1998, or

"(II) the estimate of the annual electricity production set forth in the contract, or, if there is no such estimate, the greatest annual quantity of electricity sold to the utility under the contract in any of the calendar years 1996, 1997, or 1998; and

"(iii) such amendment provides that energy and capacity in excess of the limitation in clause (ii) may be—

"(I) sold to the utility only at prices that do not exceed avoided cost prices determined at the time of delivery, or

"(II) sold to a third party subject to a mutually agreed upon advance notice to the utility.

For purposes of this subparagraph, avoided cost prices shall be determined as provided for in 18 CFR 292.304(d)(1) or any successor regulation.".

(d) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

TITLE XV—REVENUE OFFSETS

SEC. 1501. RETURNS RELATING TO CANCELLATIONS OF INDEBTEDNESS BY ORGANIZATIONS LENDING MONEY.

(a) IN GENERAL.—Paragraph (2) of section 6050P(c) (relating to definitions and special rules) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ", and", and by inserting after subparagraph (C) the following new subparagraph:

"(D) any organization a significant trade or business of which is the lending of money.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to discharges of indebtedness after December 31, 1999.

SEC. 1502. EXTENSION OF INTERNAL REVENUE SERVICE USER FEES.

(a) IN GENERAL.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end the following new section:

"SEC. 7527. INTERNAL REVENUE SERVICE USER FEES.

"(a) GENERAL RULE.—The Secretary shall establish a program requiring the payment of user fees for—

"(1) requests to the Internal Revenue Service for ruling letters, opinion letters, and determination letters, and

"(2) other similar requests.

"(b) PROGRAM CRITERIA.—

"(1) IN GENERAL.—The fees charged under the program required by subsection (a)—

"(A) shall vary according to categories (or subcategories) established by the Secretary,

"(B) shall be determined after taking into account the average time for (and difficulty of) complying with requests in each category (and subcategory), and

"(C) shall be payable in advance.

"(2) EXEMPTIONS, ETC.—The Secretary shall provide for such exemptions (and reduced fees) under such program as the Secretary determines to be appropriate.

"(3) AVERAGE FEE REQUIREMENT.—The average fee charged under the program required by subsection (a) shall not be less than the amount determined under the following table:

"Category:	***Average Fee:***
Employee plan ruling and opinion	*$250*
Exempt organization ruling	*$350*
Employee plan determination	*$300*
Exempt organization determination	*$275*
Chief counsel ruling	*$200.*

"(c) TERMINATION.—No fee shall be imposed under this section with respect to requests made after September 30, 2009.".

(b) CONFORMING AMENDMENTS.—

(1) The table of sections for chapter 77 is amended by adding at the end the following new item:

"Sec. 7527. Internal Revenue Service user fees.".

(2) Section 10511 of the Revenue Act of 1987 is repealed.

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

SEC. 1503. LIMITATIONS ON WELFARE BENEFIT FUNDS OF 10 OR MORE EMPLOYER PLANS.

(a) BENEFITS TO WHICH EXCEPTION APPLIES.—Section 419A(f)(6)(A) (relating to exception for 10 or more employer plans) is amended to read as follows:

"(A) IN GENERAL.—This subpart shall not apply to a welfare benefit fund which is part of a 10 or more employer plan if the only benefits provided through the fund are 1 or more of the following:

"(i) Medical benefits.

"(ii) Disability benefits.

"(iii) Group term life insurance benefits which do not provide directly or indirectly for any cash surrender value or other money that can be paid, assigned, borrowed, or pledged for collateral for a loan.

The preceding sentence shall not apply to any plan which maintains experience-rating arrangements with respect to individual employers.".

(b) LIMITATION ON USE OF AMOUNTS FOR OTHER PURPOSES.—Section 4976(b) (defining disqualified benefit) is amended by adding at the end the following new paragraph:

"(5) SPECIAL RULE FOR 10 OR MORE EMPLOYER PLANS EXEMPTED FROM PREFUNDING LIMITS.—For purposes of paragraph (1)(C), if—

"(A) subpart D of part I of subchapter D of chapter 1 does not apply by reason of section 419A(f)(6) to contributions to provide 1 or more welfare benefits through a welfare benefit fund under a 10 or more employer plan, and

"(B) any portion of the welfare benefit fund attributable to such contributions is used for a purpose other than that for which the contributions were made,

then such portion shall be treated as reverting to the benefit of the employers maintaining the fund.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions paid or accrued after June 9, 1999, in taxable years ending after such date.

SEC. 1504. INCREASE IN ELECTIVE WITHHOLDING RATE FOR NONPERIODIC DISTRIBUTIONS FROM DEFERRED COMPENSATION PLANS.

(a) IN GENERAL.—Section 3405(b)(1) (relating to withholding) is amended by striking "10 percent" and inserting "15 percent".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions after December 31, 2000.

SEC. 1505. CONTROLLED ENTITIES INELIGIBLE FOR REIT STATUS.

(a) IN GENERAL.—Subsection (a) of section 856 (relating to definition of real estate investment trust) is amended by striking "and" at the end of paragraph (6), by redesignating paragraph (7) as paragraph (8), and by inserting after paragraph (6) the following new paragraph:

"(7) which is not a controlled entity (as defined in subsection (l)); and".

(b) CONTROLLED ENTITY.—Section 856 is amended by adding at the end the following new subsection:

"(l) CONTROLLED ENTITY.—

"(1) IN GENERAL.—For purposes of subsection (a)(7), an entity is a controlled entity if, at any time during the taxable year, one person (other than a qualified entity)—

"(A) in the case of a corporation, owns stock—

"(i) possessing at least 50 percent of the total voting power of the stock of such corporation, or

"(ii) having a value equal to at least 50 percent of the total value of the stock of such corporation, or

"(B) in the case of a trust, owns beneficial interests in the trust which would meet the requirements of subparagraph (A) if such interests were stock.

"(2) QUALIFIED ENTITY.—For purposes of paragraph (1), the term 'qualified entity' means—

"(A) any real estate investment trust, and

"(B) any partnership in which one real estate investment trust owns at least 50 percent of the capital and profits interests in the partnership.

"(3) ATTRIBUTION RULES.—For purposes of this paragraphs (1) and (2)—

"(A) IN GENERAL.—Rules similar to the rules of subsections (d)(5) and (h)(3) shall apply; except that section 318(a)(3)(C) shall not be applied under such rules to treat stock owned by a qualified entity as being owned by a person which is not a qualified entity.

"(B) STAPLED ENTITIES.—A group of entities which are stapled entities (as defined in section 269B(c)(2)) shall be treated as 1 person.

"(4) EXCEPTION FOR CERTAIN NEW REITS.—

"(A) IN GENERAL.—The term 'controlled entity' shall not include an incubator REIT.

"(B) INCUBATOR REIT.—A corporation shall be treated as an incubator REIT for any taxable year during the eligibility period if it meets all the following requirements for such year:

"(i) The corporation elects to be treated as an incubator REIT.

"(ii) The corporation has only voting common stock outstanding.

"(iii) Not more than 50 percent of the corporation's real estate assets consist of mortgages.

"(iv) From not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation's capital is provided by lenders or equity investors who are unrelated to the corporation's largest shareholder.

"(v) The corporation annually increases the value of its real estate assets by at least 10 percent.

"(vi) The directors of the corporation adopt a resolution setting forth an intent to engage in a going public transaction.

No election may be made with respect to any REIT if an election under this subsection was in effect for any predecessor of such REIT.

"(C) ELIGIBILITY PERIOD.—

"(i) IN GENERAL.—The eligibility period (for which an incubator REIT election can be made) begins with the REIT's second taxable year and ends at the close of the REIT's third taxable year, except that the REIT may, subject to clauses (ii), (iii), and (iv), elect to extend such period for an additional 2 taxable years.

"(ii) GOING PUBLIC TRANSACTION.—A REIT may not elect to extend the eligibility period under clause (i) unless it enters into an agreement with the Secretary that if it does not engage in a going public transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the 2 years of the extended eligibility period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those 2 taxable years.

"(iii) RETURNS, INTEREST, AND NOTICE.—

"(I) RETURNS.—In the event the corporation ceases to be treated as a REIT by operation of clause (ii), the corporation shall file any appropriate amended returns reflecting the change in status within 3 months of the close of the extended eligibility period.

"(II) INTEREST.—Interest shall be payable on any tax imposed by reason of clause (ii) for any taxable year but, unless there was a finding under subparagraph (D), no substantial underpayment penalties shall be imposed.

"(III) NOTICE.—The corporation shall, at the same time it files its returns under subclause (I), notify its shareholders and any other persons

whose tax position is, or may reasonably be expected to be, affected by the change in status so they also may file any appropriate amended returns to conform their tax treatment consistent with the corporation's loss of REIT status.

"(IV) REGULATIONS.—The Secretary shall provide appropriate regulations setting forth transferee liability and other provisions to ensure collection of tax and the proper administration of this provision.

"(iv) Clauses (ii) and (iii) shall not apply if the corporation allows its incubator REIT status to lapse at the end of the initial 2-year eligibility period without engaging in a going public transaction if the corporation is not a controlled entity as of the beginning of its fourth taxable year. In such a case, the corporation's directors may still be liable for the penalties described in subparagraph (D) during the eligibility period.

"(D) SPECIAL PENALTIES.—If the Secretary determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 shall be imposed on each of the corporation's directors for each taxable year for which an election was in effect.

"(E) GOING PUBLIC TRANSACTION.—For purposes of this paragraph, a going public transaction means—

"(i) a public offering of shares of the stock of the incubator REIT;

"(ii) a transaction, or series of transactions, that results in the stock of the incubator REIT being regularly traded on an established securities market and that results in at least 50 percent of such stock being held by shareholders who are unrelated to persons who held such stock before it began to be so regularly traded; or

"(iii) any transaction resulting in ownership of the REIT by 200 or more persons (excluding the largest single shareholder) who in the aggregate own at least 50 percent of the stock of the REIT.

For the purposes of this subparagraph, the rules of paragraph (3) shall apply in determining the ownership of stock.

"(F) DEFINITIONS.—The term 'established securities market' shall have the meaning set forth in the regulations under section 897.".

(c) CONFORMING AMENDMENT.—Paragraph (2) of section 856(h) is amended by striking "and (6)" each place it appears and inserting ", (6), and (7)".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after July 14, 1999.

(2) EXCEPTION FOR EXISTING CONTROLLED ENTITIES.—The amendments made by this section shall not apply to any entity which is a controlled entity (as defined in section 856(l) of the

Internal Revenue Code of 1986, as added by this section) as of July 14, 1999, which is a real estate investment trust for the taxable year which includes such date, and which has significant business assets or activities as of such date. For purposes of the preceding sentence, an entity shall be treated as such a controlled entity on July 14, 1999, if it becomes such an entity after such date in a transaction—

(A) made pursuant to a written agreement which was binding on such date and at all times thereafter, or

(B) described on or before such date in a filing with the Securities and Exchange Commission required solely by reason of the transaction.

SEC. 1506. TREATMENT OF GAIN FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

(a) IN GENERAL.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by inserting after section 1259 the following new section:

"SEC. 1260. GAINS FROM CONSTRUCTIVE OWNERSHIP TRANSACTIONS.

"(a) IN GENERAL.—If the taxpayer has gain from a constructive ownership transaction with respect to any financial asset and such gain would (without regard to this section) be treated as a long-term capital gain—

"(1) such gain shall be treated as ordinary income to the extent that such gain exceeds the net underlying long-term capital gain, and

"(2) to the extent such gain is treated as a long-term capital gain after the application of paragraph (1), the determination of the capital gain rate (or rates) applicable to such gain under section 1(h) shall be determined on the basis of the respective rate (or rates) that would have been applicable to the net underlying long-term capital gain.

"(b) INTEREST CHARGE ON DEFERRAL OF GAIN RECOGNITION.—

"(1) IN GENERAL.—If any gain is treated as ordinary income for any taxable year by reason of subsection (a)(1), the tax imposed by this chapter for such taxable year shall be increased by the amount of interest determined under paragraph (2) with respect to each prior taxable year during any portion of which the constructive ownership transaction was open. Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

"(2) AMOUNT OF INTEREST.—The amount of interest determined under this paragraph with respect to a prior taxable year is the amount of interest which would have been imposed under section 6601 on the underpayment of tax for such year which would have resulted if the gain (which is treated as ordinary income by reason of subsection (a)(1)) had been included in gross income in the taxable years in which it accrued (determined by treating the income as accruing at a constant rate equal to the applicable Federal rate as in effect on the day the transaction closed). The period during which such interest shall accrue shall end on the due date (without extensions) for the re-

turn of tax imposed by this chapter for the taxable year in which such transaction closed.

"(3) APPLICABLE FEDERAL RATE.—For purposes of paragraph (2), the applicable Federal rate is the applicable Federal rate determined under 1274(d) (compounded semiannually) which would apply to a debt instrument with a term equal to the period the transaction was open.

"(4) NO CREDITS AGAINST INCREASE IN TAX.—Any increase in tax under paragraph (1) shall not be treated as tax imposed by this chapter for purposes of determining—

"(A) the amount of any credit allowable under this chapter, or

"(B) the amount of the tax imposed by section 55.

"(c) FINANCIAL ASSET.—For purposes of this section—

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

"(A) any equity interest in any pass-thru entity, and

"(B) to the extent provided in regulations—

"(i) any debt instrument, and

"(ii) any stock in a corporation which is not a pass-thru entity.

"(2) PASS-THRU ENTITY.—For purposes of paragraph (1), the term 'pass-thru entity' means—

"(A) a regulated investment company,

"(B) a real estate investment trust,

"(C) an S corporation,

"(D) a partnership,

"(E) a trust,

"(F) a common trust fund,

"(G) a passive foreign investment company (as defined in section 1297 without regard to subsection (e) thereof),

"(H) a foreign personal holding company,

"(I) a foreign investment company (as defined in section 1246(b)), and

"(J) a REMIC.

"(d) CONSTRUCTIVE OWNERSHIP TRANSACTION.—For purposes of this section—

"(1) IN GENERAL.—The taxpayer shall be treated as having entered into a constructive ownership transaction with respect to any financial asset if the taxpayer—

"(A) holds a long position under a notional principal contract with respect to the financial asset,

"(B) enters into a forward or futures contract to acquire the financial asset,

"(C) is the holder of a call option, and is the grantor of a put option, with respect to the financial asset and such options have substantially equal strike prices and substantially contemporaneous maturity dates, or

"(D) to the extent provided in regulations prescribed by the Secretary, enters into 1 or more other transactions (or acquires 1 or more positions) that have substantially the same effect as a transaction described in any of the preceding subparagraphs.

"(2) EXCEPTION FOR POSITIONS WHICH ARE MARKED TO MARKET.—This section shall not apply to any constructive owner-

ship transaction if all of the positions which are part of such transaction are marked to market under any provision of this title or the regulations thereunder.

"(3) LONG POSITION UNDER NOTIONAL PRINCIPAL CONTRACT.—A person shall be treated as holding a long position under a notional principal contract with respect to any financial asset if such person—

"(A) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on such financial asset for a specified period, and

"(B) is obligated to reimburse (or provide credit for) all or substantially all of any decline in the value of such financial asset.

"(4) FORWARD CONTRACT.—The term 'forward contract' means any contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

"(e) NET UNDERLYING LONG-TERM CAPITAL GAIN.—For purposes of this section, in the case of any constructive ownership transaction with respect to any financial asset, the term 'net underlying long-term capital gain' means the aggregate net capital gain that the taxpayer would have had if—

"(1) the financial asset had been acquired for fair market value on the date such transaction was opened and sold for fair market value on the date such transaction was closed, and

"(2) only gains and losses that would have resulted from the deemed ownership under paragraph (1) were taken into account.

The amount of the net underlying long-term capital gain with respect to any financial asset shall be treated as zero unless the amount thereof is established by clear and convincing evidence.

"(f) SPECIAL RULE WHERE TAXPAYER TAKES DELIVERY.—Except as provided in regulations prescribed by the Secretary, if a constructive ownership transaction is closed by reason of taking delivery, this section shall be applied as if the taxpayer had sold all the contracts, options, or other positions which are part of such transaction for fair market value on the closing date. The amount of gain recognized under the preceding sentence shall not exceed the amount of gain treated as ordinary income under subsection (a). Proper adjustments shall be made in the amount of any gain or loss subsequently realized for gain recognized and treated as ordinary income under this subsection.

"(g) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

"(1) to permit taxpayers to mark to market constructive ownership transactions in lieu of applying this section, and

"(2) to exclude certain forward contracts which do not convey substantially all of the economic return with respect to a financial asset.".

(b) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end the following new item:

"Sec. 1260. Gains from constructive ownership transactions.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transactions entered into after July 11, 1999.

SEC. 1507. TRANSFER OF EXCESS DEFINED BENEFIT PLAN ASSETS FOR RETIREE HEALTH BENEFITS.

(a) EXTENSION.—

(1) IN GENERAL.—Paragraph (5) of section 420(b) (relating to expiration) is amended by striking "in any taxable year beginning after December 31, 2000" and inserting "made after September 30, 2009".

(2) CONFORMING AMENDMENTS.—

(A) Section 101(e)(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1021(e)(3)) is amended by striking "1995" and inserting "2001".

(B) Section 403(c)(1) of such Act (29 U.S.C. 1103(c)(1)) is amended by striking "1995" and inserting "2001".

(C) Paragraph (13) of section 408(b) of such Act (29 U.S.C. 1108(b)(13)) is amended—

(i) by striking "in a taxable year beginning before January 1, 2001" and inserting "made before October 1, 2009", and

(ii) by striking "1995" and inserting "2001".

(b) APPLICATION OF MINIMUM COST REQUIREMENTS.—

(1) IN GENERAL.—Paragraph (3) of section 420(c) is amended to read as follows:

"(3) MINIMUM COST REQUIREMENTS.—

"(A) IN GENERAL.—The requirements of this paragraph are met if each group health plan or arrangement under which applicable health benefits are provided provides that the applicable employer cost for each taxable year during the cost maintenance period shall not be less than the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the qualified transfer.

"(B) APPLICABLE EMPLOYER COST.—For purposes of this paragraph, the term 'applicable employer cost' means, with respect to any taxable year, the amount determined by dividing—

"(i) the qualified current retiree health liabilities of the employer for such taxable year determined—

"(I) without regard to any reduction under subsection (e)(1)(B), and

"(II) in the case of a taxable year in which there was no qualified transfer, in the same manner as if there had been such a transfer at the end of the taxable year, by

"(ii) the number of individuals to whom coverage for applicable health benefits was provided during such taxable year.

"(C) ELECTION TO COMPUTE COST SEPARATELY.—An employer may elect to have this paragraph applied separately with respect to individuals eligible for benefits under title XVIII of the Social Security Act at any time during the taxable year and with respect to individuals not so eligible.

"(D) COST MAINTENANCE PERIOD.—For purposes of this paragraph, the term 'cost maintenance period' means the period of 5 taxable years beginning with the taxable year in which the qualified transfer occurs. If a taxable year is in 2 or more overlapping cost maintenance periods, this paragraph shall be applied by taking into account the highest applicable employer cost required to be provided under subparagraph (A) for such taxable year.".

(2) CONFORMING AMENDMENTS.—

(A) Clause (iii) of section 420(b)(1)(C) is amended by striking "benefits" and inserting "cost".

(B) Subparagraph (D) of section 420(e)(1) is amended by striking "and shall not be subject to the minimum benefit requirements of subsection (c)(3)" and inserting "or in calculating applicable employer cost under subsection (c)(3)(B)".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to qualified transfers occurring after the date of the enactment of this Act.

(2) TRANSITION RULE.—If the cost maintenance period for any qualified transfer after the date of the enactment of this Act includes any portion of a benefit maintenance period for any qualified transfer on or before such date, the amendments made by subsection (b) shall not apply to such portion of the cost maintenance period (and such portion shall be treated as a benefit maintenance period).

SEC. 1508. MODIFICATION OF INSTALLMENT METHOD AND REPEAL OF INSTALLMENT METHOD FOR ACCRUAL METHOD TAXPAYERS.

(a) REPEAL OF INSTALLMENT METHOD FOR ACCRUAL BASIS TAXPAYERS.—

(1) IN GENERAL.—Subsection (a) of section 453 (relating to installment method) is amended to read as follows:

"(a) USE OF INSTALLMENT METHOD.—

"(1) IN GENERAL.—Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method.

"(2) ACCRUAL METHOD TAXPAYER.—The installment method shall not apply to income from an installment sale if such income would be reported under an accrual method of accounting without regard to this section. The preceding sentence shall not apply to a disposition described in subparagraph (A) or (B) of subsection (l)(2).".

(2) CONFORMING AMENDMENTS.—Sections 453(d)(1), 453(i)(1), and 453(k) are each amended by striking "(a)" each place it appears and inserting "(a)(1)".

(b) MODIFICATION OF PLEDGE RULES.—Paragraph (4) of section 453A(d) (relating to pledges, etc., of installment obligations) is amended by adding at the end the following: "A payment shall be treated as directly secured by an interest in an installment obligation to the extent an arrangement allows the taxpayer to satisfy all or a portion of the indebtedness with the installment obligation.".

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

SEC. 1509. LIMITATION ON USE OF NONACCRUAL EXPERIENCE METHOD OF ACCOUNTING.

(a) IN GENERAL.—Section 448(d)(5) (relating to special rule for services) is amended—

(1) by inserting "in fields described in paragraph (2)(A)" after "services by such person", and

(2) by inserting "CERTAIN PERSONAL" before "SERVICES" in the heading.

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer required by the amendments made by this section to change its method of accounting for its first taxable year ending after the date of the enactment of this Act—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary of the Treasury, and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account over a period (not greater than 4 taxable years) beginning with such first taxable year.

SEC. 1510. CHARITABLE SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.

(a) IN GENERAL.—Subsection (f) of section 170 (relating to disallowance of deduction in certain cases and special rules) is amended by adding at the end the following new paragraph:

"(10) SPLIT-DOLLAR LIFE INSURANCE, ANNUITY, AND ENDOWMENT CONTRACTS.—

"(A) IN GENERAL.—Nothing in this section or in section 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2), or 2522 shall be construed to allow a deduction, and no deduction shall be allowed, for any transfer to or for the use of an organization described in subsection (c) if in connection with such transfer—

"(i) the organization directly or indirectly pays, or has previously paid, any premium on any personal benefit contract with respect to the transferor, or

"(ii) there is an understanding or expectation that any person will directly or indirectly pay any premium on any personal benefit contract with respect to the transferor.

"(B) PERSONAL BENEFIT CONTRACT.—For purposes of subparagraph (A), the term 'personal benefit contract' means, with respect to the transferor, any life insurance, annuity, or endowment contract if any direct or indirect beneficiary under such contract is the transferor, any member of the transferor's family, or any other person (other

than an organization described in subsection (c)) designated by the transferor.

"(C) APPLICATION TO CHARITABLE REMAINDER TRUSTS.—In the case of a transfer to a trust referred to in subparagraph (E), references in subparagraphs (A) and (F) to an organization described in subsection (c) shall be treated as a reference to such trust.

"(D) EXCEPTION FOR CERTAIN ANNUITY CONTRACTS.—If, in connection with a transfer to or for the use of an organization described in subsection (c), such organization incurs an obligation to pay a charitable gift annuity (as defined in section 501(m)) and such organization purchases any annuity contract to fund such obligation, persons receiving payments under the charitable gift annuity shall not be treated for purposes of subparagraph (B) as indirect beneficiaries under such contract if—

"(i) such organization possesses all of the incidents of ownership under such contract,

"(ii) such organization is entitled to all the payments under such contract, and

"(iii) the timing and amount of payments under such contract are substantially the same as the timing and amount of payments to each such person under such obligation (as such obligation is in effect at the time of such transfer).

"(E) EXCEPTION FOR CERTAIN CONTRACTS HELD BY CHARITABLE REMAINDER TRUSTS.—A person shall not be treated for purposes of subparagraph (B) as an indirect beneficiary under any life insurance, annuity, or endowment contract held by a charitable remainder annuity trust or a charitable remainder unitrust (as defined in section 664(d)) solely by reason of being entitled to any payment referred to in paragraph (1)(A) or (2)(A) of section 664(d) if—

"(i) such trust possesses all of the incidents of ownership under such contract, and

"(ii) such trust is entitled to all the payments under such contract.

"(F) EXCISE TAX ON PREMIUMS PAID.—

"(i) IN GENERAL.—There is hereby imposed on any organization described in subsection (c) an excise tax equal to the premiums paid by such organization on any life insurance, annuity, or endowment contract if the payment of premiums on such contract is in connection with a transfer for which a deduction is not allowable under subparagraph (A), determined without regard to when such transfer is made.

"(ii) PAYMENTS BY OTHER PERSONS.—For purposes of clause (i), payments made by any other person pursuant to an understanding or expectation referred to in subparagraph (A) shall be treated as made by the organization.

"(iii) REPORTING.—Any organization on which tax is imposed by clause (i) with respect to any premium shall file an annual return which includes—

"(I) the amount of such premiums paid during the year and the name and TIN of each beneficiary under the contract to which the premium relates, and

"(II) such other information as the Secretary may require.

The penalties applicable to returns required under section 6033 shall apply to returns required under this clause. Returns required under this clause shall be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

"(iv) CERTAIN RULES TO APPLY.—The tax imposed by this subparagraph shall be treated as imposed by chapter 42 for purposes of this title other than subchapter B of chapter 42.

"(G) SPECIAL RULE WHERE STATE REQUIRES SPECIFICATION OF CHARITABLE GIFT ANNUITANT IN CONTRACT.—In the case of an obligation to pay a charitable gift annuity referred to in subparagraph (D) which is entered into under the laws of a State which requires, in order for the charitable gift annuity to be exempt from insurance regulation by such State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in such State, the requirements of clauses (i) and (ii) of subparagraph (D) shall be treated as met if—

"(i) such State law requirement was in effect on February 8, 1999,

"(ii) each such beneficiary under the charitable gift annuity is a bona fide resident of such State at the time the obligation to pay a charitable gift annuity is entered into, and

"(iii) the only persons entitled to payments under such contract are persons entitled to payments as beneficiaries under such obligation on the date such obligation is entered into.

"(H) MEMBER OF FAMILY.—For purposes of this paragraph, an individual's family consists of the individual's grandparents, the grandparents of such individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

"(I) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this paragraph, including regulations to prevent the avoidance of such purposes.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this section, the amendment made by this section shall apply to transfers made after February 8, 1999.

(2) EXCISE TAX.—Except as provided in paragraph (3) of this subsection, section 170(f)(10)(F) of the Internal Revenue Code of 1986 (as added by this section) shall apply to premiums paid after the date of the enactment of this Act.

(3) REPORTING.—Clause (iii) of such section 170(f)(10)(F) shall apply to premiums paid after February 8, 1999 (determined as if the tax imposed by such section applies to premiums paid after such date).

SEC. 1511. RESTRICTION ON USE OF REAL ESTATE INVESTMENT TRUSTS TO AVOID ESTIMATED TAX PAYMENT REQUIREMENTS.

(a) IN GENERAL.—Subsection (e) of section 6655 (relating to estimated tax by corporations) is amended by adding at the end the following new paragraph:

"(5) TREATMENT OF CERTAIN REIT DIVIDENDS.—

"(A) IN GENERAL.—Any dividend received from a closely held real estate investment trust by any person which owns (after application of subsections (d)(5) and (l)(3)(B) of section 856) 10 percent or more (by vote or value) of the stock or beneficial interests in the trust shall be taken into account in computing annualized income installments under paragraph (2) in a manner similar to the manner under which partnership income inclusions are taken into account.

"(B) CLOSELY HELD REIT.—For purposes of subparagraph (A), the term 'closely held real estate investment trust' means a real estate investment trust with respect to which 5 or fewer persons own (after application of subsections (d)(5) and (l)(3)(B) of section 856) 50 percent or more (by vote or value) of the stock or beneficial interests in the trust.".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to estimated tax payments due on or after September 15, 1999.

SEC. 1512. MODIFICATION OF ANTI-ABUSE RULES RELATED TO ASSUMPTION OF LIABILITY.

(a) IN GENERAL.—Section 357(b)(1) (relating to tax avoidance purpose) is amended—

(1) by striking "the principal purpose" and inserting "a principal purpose", and

(2) by striking "on the exchange" in subparagraph (A).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to assumptions of liability after July 14, 1999.

SEC. 1513. ALLOCATION OF BASIS ON TRANSFERS OF INTANGIBLES IN CERTAIN NONRECOGNITION TRANSACTIONS.

(a) TRANSFERS TO CORPORATIONS.—Section 351 (relating to transfer to corporation controlled by transferor) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) TREATMENT OF TRANSFERS OF INTANGIBLE PROPERTY.—

"(1) TRANSFERS OF LESS THAN ALL SUBSTANTIAL RIGHTS.

"(A) IN GENERAL.—A transfer of an interest in intangible property (as defined in section 936(h)(3)(B)) shall be treated under this section as a transfer of property even if the transfer is of less than all of the substantial rights of the transferor in the property.

"(B) ALLOCATION OF BASIS.—In the case of a transfer of less than all of the substantial rights of the transferor in

the intangible property, the transferor's basis immediately before the transfer shall be allocated among the rights retained by the transferor and the rights transferred on the basis of their respective fair market values.

"(2) NONRECOGNITION NOT TO APPLY TO INTANGIBLE PROPERTY DEVELOPED FOR TRANSFEREE.—This section shall not apply to a transfer of intangible property developed by the transferor or any related person if such development was pursuant to an arrangement with the transferee.".

(b) TRANSFERS TO PARTNERSHIPS.—Subsection (d) of section 721 is amended to read as follows:

"(d) TRANSFERS OF INTANGIBLE PROPERTY.—

"(1) IN GENERAL.—Rules similar to the rules of section 351(h) shall apply for purposes of this section.

"(2) TRANSFERS TO FOREIGN PARTNERSHIPS.—For regulatory authority to treat intangibles transferred to a partnership as sold, see section 367(d)(3).".

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

SEC. 1514. DISTRIBUTIONS TO A CORPORATE PARTNER OF STOCK IN ANOTHER CORPORATION.

(a) IN GENERAL.—Section 732 (relating to basis of distributed property other than money) is amended by adding at the end the following new subsection:

"(f) CORRESPONDING ADJUSTMENT TO BASIS OF ASSETS OF A DISTRIBUTED CORPORATION CONTROLLED BY A CORPORATE PARTNER.—

"(1) IN GENERAL.—If—

"(A) a corporation (hereafter in this subsection referred to as the 'corporate partner') receives a distribution from a partnership of stock in another corporation (hereafter in this subsection referred to as the 'distributed corporation'),

"(B) the corporate partner has control of the distributed corporation immediately after the distribution or at any time thereafter, and

"(C) the partnership's adjusted basis in such stock immediately before the distribution exceeded the corporate partner's adjusted basis in such stock immediately after the distribution,

then an amount equal to such excess shall be applied to reduce (in accordance with subsection (c)) the basis of property held by the distributed corporation at such time (or, if the corporate partner does not control the distributed corporation at such time, at the time the corporate partner first has such control).

"(2) EXCEPTION FOR CERTAIN DISTRIBUTIONS BEFORE CONTROL ACQUIRED.—Paragraph (1) shall not apply to any distribution of stock in the distributed corporation if—

"(A) the corporate partner does not have control of such corporation immediately after such distribution, and

"(B) the corporate partner establishes to the satisfaction of the Secretary that such distribution was not part of a plan or arrangement to acquire control of the distributed corporation.

"(3) LIMITATIONS ON BASIS REDUCTION.—

"(A) IN GENERAL.—The amount of the reduction under paragraph (1) shall not exceed the amount by which the sum of the aggregate adjusted bases of the property and the amount of money of the distributed corporation exceeds the corporate partner's adjusted basis in the stock of the distributed corporation.

"(B) REDUCTION NOT TO EXCEED ADJUSTED BASIS OF PROPERTY.—No reduction under paragraph (1) in the basis of any property shall exceed the adjusted basis of such property (determined without regard to such reduction).

"(4) GAIN RECOGNITION WHERE REDUCTION LIMITED.—If the amount of any reduction under paragraph (1) (determined after the application of paragraph (3)(A)) exceeds the aggregate adjusted bases of the property of the distributed corporation—

"(A) such excess shall be recognized by the corporate partner as long-term capital gain, and

"(B) the corporate partner's adjusted basis in the stock of the distributed corporation shall be increased by such excess.

"(5) CONTROL.—For purposes of this subsection, the term 'control' means ownership of stock meeting the requirements of section 1504(a)(2).

"(6) INDIRECT DISTRIBUTIONS.—For purposes of paragraph (1), if a corporation acquires (other than in a distribution from a partnership) stock the basis of which is determined (by reason of being distributed from a partnership) in whole or in part by reference to subsection (a)(2) or (b), the corporation shall be treated as receiving a distribution of such stock from a partnership.

"(7) SPECIAL RULE FOR STOCK IN CONTROLLED CORPORATION.—If the property held by a distributed corporation is stock in a corporation which the distributed corporation controls, this subsection shall be applied to reduce the basis of the property of such controlled corporation. This subsection shall be reapplied to any property of any controlled corporation which is stock in a corporation which it controls.

"(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations to avoid double counting and to prevent the abuse of such purposes.".

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendment made by this section shall apply to distributions made after July 14, 1999.

(2) PARTNERSHIPS IN EXISTENCE ON JULY 14, 1999.—In the case of a corporation which is a partner in a partnership as of July 14, 1999, the amendment made by this section shall apply to distributions made to such partner from such partnership after the date of the enactment of this Act.

SEC. 1515. PROHIBITED ALLOCATIONS OF S CORPORATION STOCK HELD BY AN ESOP.

(a) IN GENERAL.—Section 409 (relating to qualifications for tax credit employee stock ownership plans) is amended by redesignating

subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

"(p) PROHIBITED ALLOCATION OF SECURITIES IN AN S CORPORATION.—

"(1) IN GENERAL.—An employee stock ownership plan holding employer securities consisting of stock in an S corporation shall provide that no portion of the assets of the plan attributable to (or allocable in lieu of) such employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a)) for the benefit of any disqualified individual.

"(2) FAILURE TO MEET REQUIREMENTS.—If a plan fails to meet the requirements of paragraph (1)—

"(A) the plan shall be treated as having distributed to any disqualified individual the amount allocated to the account of such individual in violation of paragraph (1) at the time of such allocation,

"(B) the provisions of section 4979A shall apply, and

"(C) the statutory period for the assessment of any tax imposed by section 4979A shall not expire before the date which is 3 years from the later of—

"(i) the allocation of employer securities resulting in the failure under paragraph (1) giving rise to such tax, or

"(ii) the date on which the Secretary is notified of such failure.

"(3) NONALLOCATION YEAR.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'nonallocation year' means any plan year of an employee stock ownership plan if, at any time during such plan year—

"(i) such plan holds employer securities consisting of stock in an S corporation, and

"(ii) disqualified individuals own at least 50 percent of the number of outstanding shares of stock in such S corporation.

"(B) ATTRIBUTION RULES.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The rules of section 318(a) shall apply for purposes of determining ownership, except that—

"(I) in applying paragraph (1) thereof, the members of an individual's family shall include members of the family described in paragraph (4)(D), and

"(II) paragraph (4) thereof shall not apply.

"(ii) DEEMED-OWNED SHARES.—Notwithstanding the employee trust exception in section 318(a)(2)(B)(i), disqualified individuals shall be treated as owning deemed-owned shares.

"(4) DISQUALIFIED INDIVIDUAL.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'disqualified individual' means any individual who is a participant or beneficiary under the employee stock ownership plan if—

"(i) the aggregate number of deemed-owned shares of such individual and the members of the individual's family is at least 20 percent of the number of outstanding shares of stock in the S corporation constituting employer securities of such plan, or

"(ii) if such individual is not described in clause (i), the number of deemed-owned shares of such individual is at least 10 percent of the number of outstanding shares of stock in such corporation.

"(B) TREATMENT OF FAMILY MEMBERS.—In the case of a disqualified individual described in subparagraph (A)(i), any member of the individual's family with deemed-owned shares shall be treated as a disqualified individual if not otherwise a disqualified individual under subparagraph (A).

"(C) DEEMED-OWNED SHARES.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'deemed-owned shares' means, with respect to any participant or beneficiary under the employee stock ownership plan—

"(I) the stock in the S corporation constituting employer securities of such plan which is allocated to such participant or beneficiary under the plan, and

"(II) such participant's or beneficiary's share of the stock in such corporation which is held by such trust but which is not allocated under the plan to employees.

"(ii) INDIVIDUAL'S SHARE OF UNALLOCATED STOCK.—For purposes of clause (i)(II), an individual's share of unallocated S corporation stock held by the trust is the amount of the unallocated stock which would be allocated to such individual if the unallocated stock were allocated to individuals in the same proportions as the most recent stock allocation under the plan.

"(D) MEMBER OF FAMILY.—For purposes of this paragraph, the term 'member of the family' means, with respect to any individual—

"(i) the spouse of the individual,

"(ii) an ancestor or lineal descendant of the individual or the individual's spouse,

"(iii) a brother or sister of the individual or the individual's spouse and any lineal descendant of the brother or sister, and

"(iv) the spouse of any person described in clause (ii) or (iii).

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

"(A) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' has the meaning given such term by section 4975(e)(7).

"(B) EMPLOYER SECURITIES.—The term 'employer security' has the meaning given such term by section 409(l).

"(6) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations providing for the treatment of any stock option, restricted stock, stock appreciation right, phantom stock unit, performance unit, or similar instrument granted by an S corporation as stock or not stock.".

(b) EXCISE TAX.—

(1) IN GENERAL.—Section 4979A(b) (defining prohibited allocation) is amended by striking "and" at the end of paragraph (1), by striking the period at the end of paragraph (2) and inserting ", and", and by adding at the end the following new paragraph:

"(3) any allocation of employer securities which violates the provisions of section 409(p).".

(2) LIABILITY.—Section 4979A(c) (defining liability for tax) is amended by adding at the end the following new sentence: "In the case of a prohibited allocation described in subsection (b)(3), such tax shall be paid by the S corporation the stock in which was allocated in violation of section 409(p).".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan years beginning after December 31, 2000.

(2) EXCEPTION FOR CERTAIN PLANS.—In the case of any—

(A) employee stock ownership plan established after July 14, 1999, or

(B) employee stock ownership plan established on or before such date if employer securities held by the plan consist of stock in a corporation with respect to which an election under section 1362(a) of the Internal Revenue Code of 1986 is not in effect on such date,

the amendments made by this section shall apply to plan years ending after July 14, 1999.

TITLE XVI—COMPLIANCE WITH BUDGET ACT

SEC. 1601. COMPLIANCE WITH BUDGET ACT.

(a) IN GENERAL.—Except as provided in subsection (b), all provisions of, and amendments made by, this Act which are in effect on September 30, 2009, shall cease to apply as of the close of September 30, 2009.

(b) SUNSET FOR CERTAIN PROVISIONS.—The amendments made by sections 101, 111, 121, 201, 202, 211, 214, and 1221 of this Act shall not apply to any taxable year beginning after December 31, 2008.

And the Senate agrees to the same.

For consideration of the House bill, and the Senate amendment, and modifications committed to conference:

BILL ARCHER.
DICK ARMEY.
PHILIP M. CRANE.
WM. THOMAS.

As additional conferees for consideration of sections 313, 315–16, 318, 325, 335, 338, 341–42, 344–45, 351, 362–63, 365, 369, 371, 381, 1261, 1305, and 1406 of the Senate amendment, and modifications committed to conference:

BILL GOODLING.
JOHN BOEHNER.
Managers on the Part of the House.

WM. V. ROTH, Jr.
TRENT LOTT.
Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2488) to provide for reconciliation pursuant to sections 105 and 211 of the concurrent resolution on the budget for fiscal year 2000, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clerical changes.

I. BROAD-BASED AND FAMILY TAX RELIEF

A. Reduction in Individual Income Tax Rates and Expansion of Lowest Individual Regular Income Tax Rate Bracket (sec. 101 of the House bill, secs. 101 and 102 of the Senate amendment and secs. 1 and 55 of the Code)

Present Law

Income tax rate structure

To determine regular income tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. The income bracket amounts are indexed for inflation. Separate rate schedules apply based on an individual's filing status. In order to limit multiple uses of a graduated rate schedule within a family, the net unearned income of a child under age 14 is taxed as if it were the parent's income.

Individual alternative minimum tax ("AMT") rate structure

Present law imposes the individual AMT on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. The AMT is imposed on individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent on the amount in excess of $175,000. The lower capital gains rates applicable to the regular tax also apply for purposes of the AMT.

House Bill

Individual regular tax rates

The House bill reduces the regular income tax rates by 10 percent over a 10-year period (2000–2009). Specifically, each rate is reduced by 1.0 percent for taxable years beginning in 2001–2003, 2.5 percent for taxable years beginning in 2004, 5 percent for taxable years beginning in 2005–2007, 7.5 percent for taxable years beginning in 2008, and 10 percent for taxable years beginning in 2009 and thereafter. The tax rates will be rounded up in 2001, rounded down in 2002 and 2003 and rounded up in 2004 and thereafter, annually to the nearest one-tenth of a percent. This rate reduction does not apply to the capital gains tax rates. However, a separate provision of the House bill would reduce individual capital gains rates.

Individual AMT

The House bill reduces the individual AMT tax rates by a total of 10 percent over a 10-year period (2000–2009). Specifically, the individual AMT tax rates are reduced by 1.0 percent for taxable years beginning in 2001–2003, 2.5 percent for taxable years beginning in 2004, 5 percent for taxable years beginning in 2005–2007, 7.5 percent for taxable years beginning in 2008, and 10 percent for taxable years beginning in 2009 and thereafter. The rates will be rounded annually to the nearest one-tenth of a percent, like the regular income tax rates.

Effective date

The House bill is effective for taxable years beginning after December 31, 2000.

Senate Amendment

Individual regular income tax rates

The Senate amendment reduces the lowest individual regular income tax rate from 15 percent to 14 percent. This rate reduction does not apply to the capital gains tax rates.

The Senate amendment also phases in an increase in the size of the 14-percent rate bracket. Specifically, the amendment increases the size of the otherwise applicable 14-percent rate bracket by $2,000 ($4,000 for a married couple filing a joint return) in 2006, and by $2,500 ($5,000 for a married couple filing a joint return) in 2007 and thereafter. The $2,500/$5,000 amounts in 2007 and thereafter are the total increase and are not in addition to the $2,000/$4,000 amounts in 2006. These amounts are indexed for inflation beginning in 2008.

Individual AMT

The Senate amendment does not contain a provision relating to AMT tax rates. A separate provision would make permanent the present-law provision to allow the nonrefundable personal credits fully against the AMT and to allow personal exemptions against the AMT.

Effective date

The Senate amendment provision reducing the tax rate from 15 percent to 14 percent is effective for taxable years beginning after December 31, 2000. The provision increasing the size of the 14-percent rate bracket is effective for taxable years beginning after December 31, 2005.

Conference Agreement

Individual regular income tax rates

The conference agreement reduces the individual regular income tax rates as follows: (1) from 15 percent to 14 percent; (2) from 28 percent to 27 percent; (3) from 31 percent to 30 percent; (4) from 36 percent to 35 percent; and (5) from 39.6 percent to 38.6 percent. These rate reductions do not apply to the capital gains tax rates. The reduction of the 15-percent rate to a 14-percent rate is phased-in over three years; (1) 14.5 percent in 2001 and 2002; and (2) 14 percent in 2003 and thereafter. Therefore, the 14-percent rate applies to taxable years beginning after December 31, 2002. The reductions in the other rates (both regular and AMT) are effective for taxable years beginning after December 31, 2004.

The conference agreement also widens the lowest (currently 15 percent) regular income tax rate brackets for both singles and head of households by $3,000 for taxable years beginning after December 31, 2005. For taxable years beginning after December 31, 2006, the $3,000 amounts are indexed for inflation.

Individual AMT

The conference agreement reduces the AMT rates as follows; (1) from 26 percent to 25 percent, and (2) from 28-percent rate to 27 percent. The lower capital gains rates applicable to the regular tax also apply for purposes of the AMT.

Effective date

The reduction of the 15-percent rate to a 14-percent rate is effective for taxable years beginning after December 31, 2000. The reductions in the other rates (both regular and AMT) are effective for taxable years beginning after December 31, 2004. The widening of the lowest applicable rate bracket for single and head of household returns is effective for taxable years beginning after December 31, 2005.

B. Marriage Penalty Relief Provisions Relating to the Rate Structure and Standard Deduction Amounts (sec. 111 of the House bill, secs. 201 and 209 of the Senate amendment and secs. 63 and 6013A 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 re-

sults in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

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: (1) $7,200 for married couples filing a joint return; (2) $6,250 for head of household returns; (3) $4,300 for single returns; and (4) $3,600 for married couples filing separate returns. Therefore in 1999, the basic standard deduction for joint returns is 1.674 times the basic standard deduction for single returns.

House Bill

Basic standard deduction

The House bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual in each taxable year. This increase is phased-in over three years beginning in 2001 by increasing the standard deduction for a married couple filing a joint return to 1.778 times the standard deduction for an unmarried individual in 2001 and to 1.889 times such amount in 2002. Therefore, the House bill provision is fully effective, (i.e., the basic standard deduction for a married couple will be twice the basic standard deduction for a unmarried individual) for taxable years beginning

[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.

after December 31, 2002. Also, the basic standard deduction for a married taxpayer filing separately will be increased so that it will continue to equal one-half of the basic standard deduction for a married couple filing jointly. The basic standard deduction for a head of household will be unchanged.

Effective date.—The House bill provision is effective for taxable years beginning after December 31, 2000.

Separate calculations

No provision.

Senate Amendment

Basic standard deduction

The Senate amendment increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual in each taxable year. This increase is phased-in over eight years beginning in 2001 by increasing the standard deduction for a married couple filing a joint return to: (1) 1.671 times the standard deduction for an unmarried individual in 2001; (2) 1.700 times the standard deduction for an unmarried individual in 2002; (3) 1.727 times the standard deduction for an unmarried individual in 2003; (4) 1.837 times the standard deduction for an unmarried individual in 2004; (5) 1.951 times the standard deduction for an unmarried individual in 2005; (6) 1.953 times the standard deduction for an unmarried individual in 2006; and (7) 1.973 times the standard deduction for an unmarried taxpayer in 2007. Therefore, the Senate amendment provision is fully effective, (i.e., the basic standard deduction for a married couple will be twice the basic standard deduction for a unmarried individual) for taxable years beginning after December 31, 2007. Also, the basic standard deduction for a married taxpayer filing separately will be increased so that it will continue to equal one-half of the basic standard deduction for a married couple filing jointly. The basic standard deduction for a head of household will be unchanged.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2000.

Separate calculations

Under the Senate amendment, married taxpayers have the option to calculate separate taxable income for each spouse and to be taxed as two single individuals on the same return. The tax due is calculated by applying the tax rates for single individuals to the separate taxable incomes. Under the Senate amendment, both spouses must elect to either use a standard deduction or to itemize their deductions. Thus, one spouse is not permitted to itemize deductions while the other spouse claims a standard deduction. If a married couple elects to compute taxable income separately and claim the standard deduction, the applicable standard deduction for each spouse is the standard deduction for single individuals. Under the Senate amendment, once tax liability is calculated on a separate basis, all tax credits and payments of tax are applied as if the couple is filing a joint return.

Income from the performance of services (e.g., wages, salaries, and pensions) are treated as the income of the spouse who performed the services. Income from property is divided between the spouses in accordance with their respective ownership rights in such property. Jointly owned assets are divided evenly.

Deductions generally are allocated to the spouse treated as having the income to which the deduction relates. Special rules apply for certain deductions. The deduction for contributions to an individual retirement arrangement are allocated to the spouse for whom the contribution is made. The deduction for alimony is allocated to the spouse who has the liability to pay the alimony. The deduction for contributions to medical savings accounts is allocated to the spouse with respect to whose employment or self employment the account relates.

Each spouse is entitled to claim one personal exemption. Exemptions for dependents are allocated based on each spouse's relative income.

All credits are determined as if the spouses had filed a joint return. The credit amounts are then applied against the combined tax liability of the couple as calculated under this provision.

For purposes of determining the alternative minimum tax imposed by section 55, the tentative minimum tax shall be the tax which would be computed as if the spouses had filed a joint return, and the regular tax shall be the tax liability computed under section 6013A.

The Secretary of the Treasury is directed to prescribe such regulations as may be necessary or appropriate to carry out the provision.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2004.

Conference Agreement

Basic standard deduction

The conference agreement increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual. This increase is phased-in over five years beginning in 2001 by increasing the standard deduction for a married couple filing a joint return to: (1) 1.728 times the standard deduction for an unmarried individual in 2001; (2) 1.801 times the standard deduction for an unmarried individual in 2002; (3) 1.870 times the standard deduction for an unmarried individual in 2003; (4) 1.935 times the standard deduction for an unmarried individual in 2004; and 2.000 times the standard deduction for an unmarried individual in 2005. Therefore, the provision is fully effective, (i.e., the basic standard deduction for a married couple will be twice the basic standard deduction for a unmarried individual) for taxable years beginning after December 31, 2004. Also, the basic standard deduction for a married taxpayer filing separately will be increased so that it will continue to equal one-half of the basic standard deduction for a married couple filing jointly. The basic standard deduction for a head of household will be unchanged.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Width of 15-percent rate bracket for a married couple filing a joint return

The conference agreement increases the size of the lowest (currently, 15 percent) regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual. This increase is phased-in over four years beginning in 2005 by increasing the lowest regular income tax rate bracket for a married couple filing a joint return to: (1) 1.737 times the lowest regular income tax rate bracket for an unmarried individual in 2005; (2) 1.761 times the lowest regular income tax rate bracket for an unmarried individual in 2006; (3) 1.881 times the lowest regular income tax rate bracket for an unmarried individual in 2007; and (4) 2.000 times the lowest regular income tax rate bracket for an unmarried individual in 2008. Therefore, this provision is fully effective, (i.e., the size of the lowest regular income tax rate bracket for a married couple filing a joint return will be twice the size of the lowest regular income tax rate bracket for an unmarried individual) for taxable years beginning after December 31, 2007.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

Separate calculations

The conference agreement does not include the Senate amendment provision.

C. Marriage Penalty Relief Relating to the Earned Income Credit (sec. 202 of the Senate amendment and sec. 32 of the Code)

Present Law

Certain eligible low-income workers are entitled to claim a refundable earned income credit ("EIC") on their income tax return. A refundable credit is a credit that not only reduces an individual's tax liability but allows refunds to the individual in excess of income tax liability. The amount of the credit an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children, and is determined by multiplying the credit rate by the individual's earned income up to an earned income amount. In the case of a married individual who files a joint return with his or her spouse, the income for purposes of these tests is the combined income of the couple. The maximum amount of the credit is the product of the credit rate and the earned income amount. The credit is phased out above certain income levels. For individuals with earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range, the maximum credit amount is reduced by the phase-out rate multiplied by the earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range. For individuals with earned income (or modified AGI, if greater) in excess of the end of the phase-out range, no credit is allowed.

The parameters of the credit for 1999 are provided in the following table.

EARNED INCOME CREDIT PARAMETERS (1999)

	Two or more qualifying children	One qualifying child	No qualifying children
Credit rate (percent)	40.00	34.00	7.65
Earned income amount	$9,540	$6,800	$4,530
Maximum credit	$3,816	$2,312	$347
Phase-out begins	$12,460	$12,460	$5,670
Phase-out rate (percent)	21.06	15.98	7.65
Phase-out ends	$30,580	$26,928	$10,200

House Bill

No provision.

Senate Amendment

The Senate amendment increases the beginning point of the phase out of the EIC for married couples filing a joint return by $2,000. Because the rate of the phase out is not changed by the provision, the end-point of the phase-out ranges is also increased by $2,000. The effect of the increase in the beginning point of the phase-out is to increase the EIC for taxpayers in the phase-out range by an amount up to $2,000 times the phase-out rate. For example, for couples with two or more qualifying children, the maximum increase in the EIC as a result of the proposal would be $2,000 times 21.06 percent, or $421.20. The provision also expands the universe of taxpayers eligible for the EIC. Specifically, the $2,000 increase in the end of the phase-out range makes taxpayers with earnings up to $2,000 beyond the present-law phase-out range newly eligible for the credit. Beginning in 2006, the $2,000 amount is indexed for inflation.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2004.

Conference Agreement

The conference agreement follows the Senate amendment with a modification to the effective date. The provision is effective for taxable years beginning after December 31, 2005.

D. Individual Alternative Minimum Tax Provisions (sec. 121 of the House bill, secs. 206 and 1134 of the Senate amendment, and secs. 26 and 55 of the Code)

Present Law

In general

Present law imposes a minimum tax ("AMT") on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. The AMT is imposed on individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount and (2) 28 percent on the remaining AMTI. The exemp-

tions amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return. These exemption amounts are phased-out by an amount equal to 25 percent of the amount that the individual's AMTI exceeds a threshold amount. These threshold amounts are $150,000 in the case of married individuals filing a joint return and surviving spouses; $112,500 in the case of other unmarried individuals; and $75,000 in the case of married individuals filing a separate return, estates, and trusts. The exemption amounts, the threshold phase-out amounts, and the $175,000 break-point amount are not indexed for inflation. The lower capital gains rates applicable to the regular tax apply for purposes of the AMT.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Preference items in computing AMTI

The minimum tax preference items are:

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

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

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

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

(5) Forty-two percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter, farm, or passive activities are denied.[2]

Adjustments in computing AMTI

The adjustments that individuals must make in computing AMTI are:

(1) Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after De-

[2] Given the passage of section 469 by the Tax Reform Act of 1986 (relating to the deductibility of losses from passive activities), these provisions are largely "deadwood."

cember 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence.

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

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

(4) The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

(5) Miscellaneous itemized deductions are not allowed.

(6) Itemized deductions for State, local, and foreign real property taxes, State and local personal property taxes, and State, local, and foreign income, war profits, and excess profits taxes are not allowed.

(7) Medical expenses are allowed only to the extent they exceed 10 percent of the taxpayer's adjusted gross income (AGI).

(8) Standard deductions and personal exemptions are not allowed.

(9) The amount allowable as a deduction for circulation expenditures must be capitalized and amortized over a 3-year period.

(10) The amount allowable as a deduction for research and experimental expenditures must be capitalized and amortized over a 10-year period.[3]

(11) The regular tax rules relating to incentive stock options do not apply.

Other rules

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

The various nonrefundable credits allowed under the regular tax generally are allowed only to the extent that the individual's regular tax exceeds the tentative minimum tax. The earned income credit and the child credit of those taxpayers with three or more qualified children are refundable credits and may offset the taxpayer's tentative minimum tax. However, a taxpayer must reduce these refundable credits by the amount the taxpayer's tentative minimum tax exceeds his or her regular tax liability.[4]

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative

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

[4] For 1998 only, the nonrefundable personal credits were not limited by the tentative minimum tax, and the refundable child credit was not reduced by the minimum tax.

minimum tax in such subsequent year. For individuals, the AMT credit is allowed only to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature. Most individual AMT adjustments relate to itemized deductions and personal exemptions and are not timing in nature.

House Bill

The House bill allows an individual to offset the entire regular tax liability (without regard to the minimum tax) by the personal nonrefundable credits, and also repeals the provision reducing the refundable child credit by the AMT.

The House bill phases out the individual AMT. For taxable years beginning in 2005, only 80 percent of the full AMT liability will be imposed. That percentage will be reduced to 70 percent in 2006, 60 percent in 2007, 50 percent in 2008, and the AMT will be fully repealed for taxable years beginning after 2008.

Under the House bill, an individual will be allowed to use the AMT credit to offset 90 percent of its regular tax liability (determined after the application of the other nonrefundable credits).

Effective date.—The provisions relating to the personal credits are effective for taxable years beginning after December 31, 1998. The phase-out of the AMT will be effective for taxable years beginning after December 31, 2004. The repeal of the AMT and the provision relating to the use of AMT credits apply to taxable years beginning after December 31, 2008.

Senate Amendment

The Senate amendment follows the House bill in the treatment of personal credits under the AMT.

The Senate amendment allows the personal exemption in computing AMT (except for $300 per exemption).

Effective date.—The provisions relating to the personal credits are effective for taxable years beginning after December 31, 1998. The provision relating to the personal exemption applies to taxable years beginning after December 31, 2005.

Conference Agreement

The conference agreement follows the House bill, except that the AMT is repealed for taxable years beginning after December 31, 2007.

E. Expand the Exclusion from Income for Certain Foster Care Payments (sec. 1301 of the House bill sec. 203 of the Senate amendment and sec. 131 of the Code)

Present Law

Generally, a foster care provider may exclude qualified foster care payments, (including difficulty of care payments) from gross income if certain requirements are satisfied.[5] First, such payments

[5] A difficulty of care payment is a payment designated by the person making such payment as compensation for providing the additional care of a qualified foster care individual

Continued

must be paid to the foster care providers by either (1) a State or political subdivision of a State; or (2) a tax-exempt placement agency. Second, the payments, including difficulty of care payments, must be paid to the foster care provider for the care of a "qualified foster individual" in the foster care provider's home. A qualified foster individual is an individual living in a foster care family home in which the individual was placed by: (1) an agency of the State or a political subdivision of a State; or (2) a tax-exempt placement agency if such individual was under the age of 19 at the time of placement. Third, the exclusion of foster care payments generally applies to qualified foster care payments for five or fewer foster care individuals over the age of 19 in a foster home. In the case of difficulty of care payments, the exclusion applies to payments for ten or fewer foster care individuals under the age of 19 in a foster home and to payments for five or fewer foster care individuals at least age 19 in a foster home.

House Bill

The House bill makes two principal modifications to the exclusion for qualified foster care payments. First, the House bill expands the list of persons eligible to make qualified foster care payments. Therefore, the exclusion applies to qualified payments made pursuant to a foster care program of a State or local government which are paid by either: (1) a State or political subdivision of a State; or (2) a qualified foster care placement agency, whether taxable or tax-exempt. Second, the bill expands the list of persons eligible to place foster care individuals. Specifically, the bill allows placements by either: (1) a State or a political subdivision of a State; or (2) a qualified foster care placement agency. For these purposes, a qualified foster care placement agency is defined as any placement agency which is licensed or certified by: (1) a State or political subdivision of a State; or (2) an entity designated by a State or political subdivision thereof, for the foster care program of such State or political subdivision to make payments to providers of foster care.

The House bill allows State and local governments to employ both tax-exempt and taxable entities to administer their foster care programs more efficiently; however, it does not extend the exclusion to payments outside such foster care programs (e.g., payments to a foster care provider from friends or relatives of foster care individual in its care).

Effective date.—The House bill provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

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which is required by reason of a physical, mental, or emotional handicap of such individual and with respect to which the State has determined that there is a need for additional compensation.

F. Increase and Expand the Dependent Care Credit (sec. 204 of the Senate amendment and sec. 21 of the Code)

Present Law

In general

A taxpayer who maintains a household which includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 30 percent of a limited amount of employment-related dependent care expenses. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual or $4,800 if there are two or more qualifying individuals. Generally, a qualifying individual is a dependent under the age of 13 or a physically or mentally incapacitated dependent or spouse. No credit is allowed for any qualifying individual unless a valid taxpayer identification number ("TIN") has been provided for that individual. A taxpayer is treated as maintaining a household for a period if the taxpayer (or the taxpayer's spouse, if married) provides more than one-half the cost of maintaining the household for that period. In the case of married taxpayers, the credit is not available unless they file a joint return.

Employment-related dependent care expenses are expenses for the care of a qualifying individual incurred to enable the taxpayer to be gainfully employed, other than expenses incurred for an overnight camp. For example, amounts paid for the services of a housekeeper generally qualify if such services are performed at least partly for the benefit of a qualifying individual; amounts paid for a chauffeur or gardener do not qualify.

Expenses that may be taken into account in computing the credit generally may not exceed an individual's earned income or, in the case of married taxpayers, the earned income of the spouse with the lesser earnings. Thus, if one spouse has no earned income, generally no credit is allowed.

The 30-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income ("AGI") above $10,000.

Interaction with employer-provided dependent care assistance

For purposes of the dependent care credit, the maximum amounts of employment-related expenses ($2,400/$4,800) are reduced to the extent that the taxpayer has received employer-provided dependent care assistance that is excludable from gross income (sec. 129). The exclusion for dependent care assistance is limited to $5,000 per year and does not vary with the number of children.

House Bill

No provision.

Senate Amendment

The Senate amendment makes three changes to the dependent care tax credit. First, the maximum credit percentage is increased

from 30 percent to 40 percent for taxpayers with AGI of $30,000 or less. The 40-percent credit rate is phased-down by one percentage point for each $1,000 of AGI, or fraction thereof, between $30,001 and $49,000. The credit percentage is 20 percent for taxpayers with AGI of $49,001 or greater. Second, beginning in 2001, the maximum amount of eligible employment-related expenses ($2,400/$4,800) is indexed for inflation. Finally, the Senate amendment extends up to $960 of additional credit ($1,920 for two or more qualifying dependents) to taxpayers with qualifying dependents under the age of one. This additional credit, computed as the applicable credit rate times $200 of deemed expenses per month ($400 of deemed expenses per month for two or more qualifying dependents), is available regardless of whether the taxpayer actually incurred any out-of-pocket child care expenses.

The present-law reduction of the dependent care credit for employer-provided dependent care assistance is not changed.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment with two modifications to the effective date. First, the maximum credit percentage will be 35 percent for taxable years beginning in 2001 through 2005, and 40 percent for taxable years beginning after 2005. Second, the extension of the credit to taxpayers with qualifying dependents under the age of one will be effective for taxable years beginning after 2005.

The present-law reduction of the dependent care credit for employer-provided dependent care assistance is not changed.

G. Tax Credit for Employer-Provided Child Care Facilities (sec. 205 of the Senate amendment and new sec. 45D of the Code)

Present Law

Generally, present law does not provide a tax credit to employers for supporting child care or child care resource and referral services.[6] An employer, however, may be able to claim such expenses as deductions for ordinary and necessary business expenses. Alternatively, the employer may be required to capitalize the expenses and claim depreciation deductions over time.

House Bill

No provision.

Senate Amendment

Employer tax credit for supporting employee child care

Under the Senate amendment, taxpayers receive a tax credit equal to 25 percent of qualified expenses for employee child care.

[6] An employer may claim the welfare-to-work tax credit on the eligible wages of certain long-term family assistance recipients. For purposes of the welfare-to-work credit, eligible wages includes amounts paid by the employer for dependent care assistance.

These expenses include costs incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer's qualified child care facility; (2) for the operation of the taxpayer's qualified child care facility, including the costs of training and continuing education for employees of the child care facility; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care, and the facility must be duly licensed by the State agency with jurisdiction over its operations. Also, if the facility is owned or operated by the taxpayer, at least 30 percent of the children enrolled in the center (based on an annual average or the enrollment measured at the beginning of each month) must be children of the taxpayer's employees. If a taxpayer opens a new facility, it must meet the 30-percent employee enrollment requirement within two years of commencing operations. If a new facility failed to meet this requirement, the credit would be subject to recapture.

To qualify for the credit, the taxpayer must offer child care services, either at its own facility or through third parties, on a basis that does not discriminate in favor of highly compensated employees.

Employer tax credit for child care resource and referral services

Under the Senate amendment, a taxpayer is entitled to a tax credit equal to 10 percent of expenses incurred to provide employees with child care resource and referral services.

Other rules

The maximum total credit that may be claimed by a taxpayer under the Senate amendment can not exceed $150,000 per year. Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Effective date

The credits are effective for taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

H. Extension and Expansion of the Adoption Tax Credit (sec. 210 of the Senate amendment and sec. 23 of the Code)

Present Law

Taxpayers are entitled to a maximum nonrefundable credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer (sec. 23). In the case of a special needs adoption, the maximum credit amount is $6,000

($5,000 in the case of a foreign special needs adoption). A special needs child is a child who the State has determined: (1) cannot or should not be returned to the home of the birth parents, and (2) has a specific factor or condition because of which the child cannot be placed with adoptive parents without adoption assistance. The adoption of a child who is not a citizen or a resident of the United States is a foreign adoption.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses that are directly related to the legal adoption of an eligible child. All reasonable and necessary expenses required by a State as a condition of adoption are qualified adoption expenses. Otherwise qualified adoption expenses paid or incurred in one taxable year are not taken into account for purposes of the credit until the next taxable year unless the expenses are paid or incurred in the year the adoption becomes final.

An eligible child is an individual (1) who has not attained age 18 or (2) who is physically or mentally incapable of caring for himself or herself. After December 31, 2001, the credit will be available only for domestic special needs adoptions. No credit is allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, (3) in connection with the adoption of a child of the taxpayer's spouse, (4) that are reimbursed under an employer adoption assistance program or otherwise, or (5) for a foreign adoption that is not finalized.

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

House Bill

No provision.

Senate Amendment

The Senate amendment makes three changes to the adoption credit. First, it provides that the maximum credit for domestic special needs adoptions is increased to $10,000 from $6,000. Second, taxpayers making a domestic special needs adoption are deemed to have paid or incurred $10,000 of qualified expenses in all cases. Third, the sunset for non-special needs adoptions is repealed.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement makes two changes to the adoption credit. First, it provides that the maximum credit for special needs adoptions is increased to $10,000 from $6,000. Second, taxpayers making a special needs adoption are deemed to have paid or incurred $10,000 of qualified expenses in all cases. The conference agreement does not change the present-law sunset of the adoption credit for non-special needs adoptions.

Effective date.—The conference agreement provision is effective for taxable years beginning after December 31, 2000.

II. SAVINGS AND INVESTMENT TAX RELIEF PROVISIONS

A. Partial Exclusion for Interest and Dividends (sec. 201 of the House 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 gross income and subject to tax.

House Bill

The House bill gives individual taxpayers an exclusion from income of interest and dividends (other than capital gain dividends from RICs and REITs, dividends from farmers' cooperative associations, and dividends received from an employee stock ownership plan), received during a taxable year.[7] This exclusion is phased-in over five years. The maximum exclusion from income is $50 of combined interest and dividends ($100 for married couples filing a joint return) for taxable years beginning in 2001 and 2002. The maximum exclusion from income is $100 of combined interest and dividends ($200 for married couples filing a joint return) for taxable years beginning in 2003 and 2004. The maximum exclusion is $200 of combined interest and dividends ($400 for married couples filing a joint return) for taxable years beginning after December 31, 2004. The amount of the combined interest and dividends excluded under the House bill is in addition to the amount of any interest or dividend which is exempt from tax under any other provision (e.g., interest on certain State and local bonds which is exempt from tax under section 103 of the Code).

In determining eligibility for the earned income credit ("EIC"), any interest or dividends excluded from gross income under the House bill are included in modified adjusted gross income for purposes of phase-out rules of the EIC and disqualified income for purposes of the EIC disqualified income test. Similarly, any interest or dividends excluded from gross income under the House bill are included in modified adjusted gross income for purposes of the taxation of certain Social Security benefits.

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

The exclusion under the House bill is in addition to, and is 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

[7] 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 proposal is generally parallel to that provision. The exclusion for dividends was repealed by the Tax Reform Act of 1986.

under this provision be computed without regard to the exclusion under section 135.

In addition, the IRS is encouraged to simplify the process of completing tax forms to the greatest extent practicable, including, for example, considering raising the administratively-established dollar thresholds for completing Schedule B or for being able to use the Form 1040EZ.

Effective date.—The House bill provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

B. Individual Capital Gains (sec. 202 of the House bill, sec. 207 of the Senate amendment, and secs. 1(h) and 1022 of the Code)

Present Law

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, any gain generally is included in income, and the net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year. In determining gain or loss, no adjustment is allowed for inflation.

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

The maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. In addition, any adjusted net capital gain which otherwise would be taxed at the lowest individual rate (currently 15 percent) is taxed at a 10-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain which the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) ("collectibles gain and loss"), an amount of gain equal to the amount of gain excluded from gross income under section 1202, relating to certain small business stock ("section 1202 gain"),[8] the net short-term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, rather than only to a portion of the depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies shall not exceed the net section 1231 gain for the year.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent.

For taxable years beginning after December 31, 2000, any gain from the sale or exchange of property held more than five years which would otherwise be taxed at the 10-percent rate will instead be taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which begins after December 31, 2000, which would otherwise be taxed at a 20-percent rate will be taxed at an 18-percent rate. A taxpayer holding a capital asset or property used in the trade or business on January 1, 2001, may elect to treat the asset as having been sold in a taxable transaction on that date for an amount equal to its fair market value, and having been reacquired for an amount equal to such value.

House Bill

The House bill reduces the 10- and 20-percent rates on the adjusted net capital gain to 7.5 and 15 percent, respectively. The 25-percent rate on unrecaptured section 1250 gain is reduced to 20 percent. These lower rates apply to both the regular tax and the alternative minimum tax.[9]

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[8] This results in a maximum effective regular tax rate on qualified gain from small business stock of 14 percent.

[9] The provision does not change the regular tax rate for gain from collectibles and small business stock. The provision reduces the maximum effective AMT rate on small business stock to slightly below 15 percent (depending on the amount of individual rate cut for the taxable year).

The bill repeals the 8- and 18-percent rates on certain gain from property held more than 5 years.

Effective date.—The provision applies to taxable years ending on or after July 1, 1999.

For taxable years which include July 1, 1999, the lower rates apply to amounts properly taken into account for the portion of the year on or after that date. This generally has the effect of applying the lower rates to capital assets sold or exchanged (and installment payments received) on or after July 1, 1999. In the case of gain taken into account by a pass-through entity, the date taken into account by the entity is the appropriate date for applying this rule.

Senate Amendment

The Senate amendment allows an individual a deduction for up to $1,000 of net capital gain. Collectible gain and loss is taxed as short-term capital gain or loss.

Effective date.—The provision is effective for taxable years beginning after December 31, 2005.

Conference Agreement

Rates

The conference agreement follows the House bill, except that the rates on adjusted net capital gain are reduced to 8 and 18 percent respectively, and the rate on unrecaptured section 1250 gain is reduced to 23 percent.

Effective date.—The reduced rates apply to taxable years beginning after December 31, 1998.

Indexing

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

Assets eligible for the inflation adjustment generally include common (but not preferred) stock of C corporations and tangible property that are capital assets or property used in a trade or business. A personal residence does not qualify for indexing.

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

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

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

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

Stock in an S corporation or an interest in a partnership or common trust fund is not an indexed asset. Under the provision, the individual owner receives the benefit of the indexing adjustment when the S corporation, partnership, or common trust fund disposes of indexed assets. Under the provision, any inflation adjustments at the entity level flows through to the holders and result in a corresponding increase in the basis of the holder's interest in the entity. Where a partnership has a section 754 election in effect, a partner transferring his interest in the partnership is entitled to any indexing adjustment that has accrued at the partnership level with respect to the partner and the transferee partner is entitled to the benefits of indexing for inflation occurring after the transfer.

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

Common stock of a foreign corporation generally is an indexed asset if the stock is regularly traded on an established securities market. Indexed assets, however, do not include stock in a foreign investment company, a passive foreign investment company (including a qualified electing fund), a foreign personal holding company, or, in the hands of a shareholder who meets the requirements of section 1248(a)(2) (generally pertaining to 10-percent shareholders of controlled foreign corporations), any other foreign corporation. An American Depository Receipt (ADR) for common stock in a foreign corporation is treated as common stock in the foreign corporation and, therefore, the basis in an ADR for common stock generally will be indexed.

No indexing is provided for improvements or contributions to capital if the aggregate amount of the improvements or contributions to capital during the taxable year with respect to the property or stock is less than $1,000. If the aggregate amount of such improvements or contributions to capital is $1,000 or more, each addi-

tion is treated as a separate asset acquired at the close of the taxable year.

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

In the case of a short sale of an indexed asset with a short sale period in excess of one year, the proposal requires that the amount realized be indexed for inflation for the short sale period.

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

Under the provision, indexing reduces the amount of ordinary gain that would be recognized in cases where a corporation is treated as a collapsible corporation (under sec. 341) with respect to a distribution or sale of stock.

Effective date.—The indexing provision applies to assets the holding period for which begins after December 31, 1999. An individual holding an indexed asset on January 1, 2000, may elect to treat the indexed asset as having been sold on such date for its fair market value, and having been reacquired for that value. If an election is made, any gain is recognized (and any loss disallowed).

C. Apply Capital Gain Rates to Capital Gains Earned by Designated Settlement Funds (sec. 203 of the House bill and sec. 468B of the Code)

Present Law

Under present law, designated settlement funds are taxed at the highest rate of tax imposed on individuals, currently 39.6 percent, on their entire taxable income (sec. 468B).

House Bill

Under the House bill, the net capital gain of a designated settlement fund will be taxed in the same manner as in the case of an individual, i.e., the lower rates applicable to net capital gain set forth in section 1(h), as amended by the bill, will apply.

Effective date.—The provision applies to taxable years beginning after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

D. 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 or Certain Other Individuals Relocated Outside of the United States (sec. 204 of the House 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) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to: (1) members of the uniformed services or the Foreign Service of the United States or (2) individuals relocated outside of the United States.

House Bill

Under the House bill, the five-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 uniformed 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 will 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.

The House bill also suspends for up to five years, the five-year test period for an individual relocated for a period of more than 90 days outside of the United States by the individual's (or spouse's) employer. This provision does not apply to self-employed individuals.

Effective date.—The House bill provision is effective for sales or exchanges of principal residences after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

E. Clarify the Tax Treatment of Income and Losses on Derivatives (sec. 205 of the House bill, sec. 1306 of the Senate amendment, and sec. 1221 of the Code)

Present Law

Capital gain treatment applies to gain on the sale or exchange of a capital asset. Capital assets include property other than (1) stock in trade or other types of assets includible in inventory, (2) property used in a trade or business that is real property or property subject to depreciation, (3) accounts or notes receivable acquired in the ordinary course of a trade or business, (4) certain copyrights (or similar property), and (5) U.S. government publications. Gain or loss on such assets generally is treated as ordinary, rather than capital, gain or loss. Certain other Code sections also treat gains or losses as ordinary. For example, the gains or losses of securities dealers or certain electing commodities dealers or electing traders in securities or commodities that are subject to "mark-to-market" accounting are treated as ordinary (sec. 475).

Treasury regulations (which were finalized in 1994) require ordinary character treatment for most business hedges and provide timing rules requiring that gains or losses on hedging transactions be taken into account in a manner that matches the income or loss from the hedged item or items. The regulations apply to hedges that meet a standard of "risk reduction" with respect to ordinary property held (or to be held) or certain liabilities incurred (or to be incurred) by the taxpayer and that meet certain identification and other requirements (Treas. reg. sec. 1.1221–2).

House Bill

The House bill adds three categories to the list of assets the gain or loss on which is treated as ordinary (sec. 1221). The new categories are: (1) commodities derivative financial instruments entered into by derivatives dealers; (2) hedging transactions; and (3) supplies of a type regularly consumed by the taxpayer in the ordinary course of a taxpayer's trade or business. In defining a hedging transaction, the House bill generally codifies the approach taken by the Treasury regulations, but modifies the rules. The "risk reduction" standard of the regulations is broadened to "risk management" with respect to ordinary property held (or to be held) or certain liabilities incurred (or to be incurred).

Effective date.—The house bill is effective for any instrument held, acquired or entered into, any transaction entered into, and supplies held or acquired on or after the date of enactment.

Senate Amendment

The Senate amendment generally follows the House bill except that the Senate amendment makes one modification to the definition of a hedging transaction. In addition to managing certain risks with respect to ordinary property held (or to be held) or certain li-

abilities incurred (or to be incurred), the Senate amendment provides that the definition of a hedging transaction includes a transaction entered into primarily to manage such other risks as the Secretary may prescribe in regulations.

Conference Agreement

The conference agreement follows the Senate amendment.

F. Treatment of Loss on Worthless Stock of Subsidiary (sec. 206 of the House bill and sec. 165(g)(3) of the Code)

Present Law

Under present law, the loss on stock of a subsidiary corporation that becomes worthless is treated as an ordinary loss (rather than a capital loss), unless 10 percent or more of its gross receipts for all taxable years has been, with minor exceptions, from royalties, rents, dividends, interest, annuities, and gains from the sales or exchanges of stocks and securities (sec. 165(g)(3)).

House Bill

Under the House bill, income from the conduct of an active trade or business of an insurance company or financial institution will not be included as gross receipts from the types of passive income listed above. Thus, a loss recognized with respect to the worthless stock of a subsidiary corporation which is an insurance company or financial institution could be treated as an ordinary loss, rather than as a capital loss.

Effective date.—The provision applies to stock becoming worthless in taxable years beginning after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

G. Individual Retirement Arrangements ("IRAs") (sec. 113 of the House bill, secs. 301–303, 305, and 321 of the Senate amendment, and secs. 219, 408, and 408A of the Code)

Present Law

In general

There are two general types of individual retirement arrangements ("IRAs") under present law: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs. The Federal income tax rules regarding each type of IRA (and IRA contribution) differ.

Traditional IRAs

Under present law, an individual may make deductible contributions to an IRA up to the lesser of $2,000 or the individual's compensation if neither the individual nor the individual's spouse

is an active participant in an employer-sponsored retirement plan. In the case of a married couple, deductible IRA contributions of up to $2,000 can be made for each spouse (including, for example, a homemaker who does not work outside the home), if the combined compensation of both spouses is at least equal to the contributed amount. If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit is phased out for taxpayers with adjusted gross income ("AGI") over certain levels for the taxable year.

The AGI phase-out limits for taxpayers who are active participants in employer-sponsored plans are as follows.

Single Taxpayers

Taxable years beginning in:	*Phase-out range*
1998	$30,000–40,000
1999	31,000–41,000
2000	32,000–42,000
2001	33,000–43,000
2002	34,000–44,000
2003	40,000–50,000
2004	45,000–55,000
2005 and thereafter	50,000–60,000

Joint Returns

Taxable years beginning in:	*Phase-out range*
1998	$50,000–60,000
1999	51,000–61,000
2000	52,000–62,000
2001	53,000–63,000
2002	54,000–64,000
2003	60,000–70,000
2004	65,000–75,000
2005	70,000–80,000
2006	75,000–85,000
2007 and thereafter	80,000–100,000

If the individual is not an active participant in an employer-sponsored retirement plan, but the individual's spouse is, the $2,000 deduction limit is phased out for taxpayers with AGI between $150,000 and $160,000.

To the extent an individual cannot or does not make deductible contributions to an IRA or contributions to a Roth IRA, the individual may make nondeductible contributions to a traditional IRA.

Amounts held in a traditional IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Includible amounts withdrawn prior to attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, is used to purchase health insurance of an unemployed individual, is used for education expenses, or is used for first-time homebuyer expenses of up to $10,000.

Roth IRAs

Individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of $2,000 or the individual's compensation for the year. The contribution

limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. As under the rules relating to IRAs generally, a contribution of up to $2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for single individuals with AGI between $95,000 and $110,000 and for joint filers with AGI between $150,000 and $160,000.

Taxpayers with modified AGI of $100,000 or less generally may convert a traditional IRA into an Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply and, if the conversion occurred in 1998, the income inclusion may be spread ratably over 4 years. Married taxpayers who file separate returns cannot convert a traditional IRA into a Roth IRA.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) which is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies).[10] The same exceptions to the early withdrawal tax that apply to IRAs apply to Roth IRAs.

IRA investments

In general, IRAs may not invest in collectibles. Under one exception to this rule, IRAs may invest in certain gold, silver, and platinum coins and coins issued under the laws of any State.

House Bill

The House bill increases the AGI limit on conversions of traditional IRAs to Roth IRAs to $160,000 for joint filers.

Effective date.—The House bill is effective for years beginning after December 31, 1999.

Senate Amendment

Increase in annual contribution limits

The Senate amendment provision increases the maximum annual dollar contribution limit for IRA contributions in $1,000 annual increments, beginning in 2001, until the limit reaches $5,000 in 2003. Thereafter, the limit is indexed for inflation in $100 increments.

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[10] Early distribution of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

Additional catch-up contributions

The Senate amendment increases the IRA maximum contribution limit for individuals who have attained age 50 before the end of the taxable year. The otherwise maximum dollar contribution limit (before application of the AGI phase-out limits) for such an individual is increased by the applicable percentage. The applicable percentage is 10 percent in 2001, and increases by 10 percentage points until the applicable percent is 50 in 2005 and thereafter.

Increase in AGI limits for deductible IRA contributions

Under the Senate amendment provision, the AGI phase-out limits for active participants in an employer-sponsored plan is increased by $2,000 ($4,000 in the case of married taxpayers filing a joint return) in 2008 and by $2,500 ($5,000 in the case of married taxpayers filing a joint return) in 2009. Thus, the phase-out limits are as follows for taxable years beginning in 2008–2009.

Single Returns

Taxable years beginning in:	*Phase-out range*
2008	$52,000–62,000
2009	54,500–64,500

Joint Returns

Taxable years beginning in:	*Phase-out range*
2008	$84,000–104,000
2009	89,000–109,000

The present-law income phase-out range for an individual who is not an active participant, but whose spouse is, remains at $150,000 to $160,000.

AGI limits for Roth IRAs

The provision repeals the Roth IRA contribution AGI phase-out limits. The provision also increases the AGI limit on conversions of traditional IRAs to Roth IRAs to $1 million ($500,000 in the case of a married taxpayer filing a separate return).

IRA investments in coins

The provision allows IRAs to invest in any coin certified by a recognized grading service and traded on a nationally recognized electronic network, or listed by a recognized wholesale reporting service and which (1) is or was at any time legal tender in the United States, or (2) issued under the laws of any State. Such coins must be in the physical possession of the IRA trustee or custodian.

Deemed IRAs under employer plans

If a qualified retirement plan or a section 403(b) annuity permits employees to make voluntary employee contributions to a separate account or annuity that (1) is established under the qualified plan or section 403(b) annuity, and (2) meets the requirements applicable to either traditional IRAs (sec. 408) or Roth IRAs (sec. 408A), the separate account or annuity will be deemed a traditional IRA or a Roth IRA, as applicable. The deemed IRA, and contributions thereto, will not be subject to the Code rules pertaining to qualified plans or section 403(b) annuities, as applicable. In addition, the deemed IRA, and contributions thereto, will not be taken

into account in applying these rules to any other contributions under the qualified plan or section 403(b) annuity. The deemed IRA, and contributions thereto, will be subject to the exclusive benefit and fiduciary rules of ERISA, but will not be subject to the ERISA reporting and disclosure, participation, vesting, funding, and enforcement requirements that apply to pension plans.

Effective date

The Senate amendment provision generally is effective for taxable years beginning after December 31, 2000. The increase in the AGI limits for deductible IRA contributions is effective for taxable years beginning after December 31, 2007. The provision increasing the AGI limit for conversions to Roth IRAs is effective for taxable years beginning after December 31, 2002. The provision relating to IRA investment in coins is effective for taxable years beginning after December 31, 1999. The provision relating to deemed IRAs is effective for plan years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications.

Increase in annual contribution limits

Under the conference agreement, the maximum IRA contribution limit is increased from $2,000 as follows: $3,000 in 2001–2003; $4,000 in 2004–2005; $5,000 in 2006–2008, with indexing thereafter.

Additional catch-up contributions

The conference agreement follows the Senate amendment.

Increase in AGI limits for deductible IRA contributions

The conference agreement does not include the Senate amendment.

AGI limits for Roth IRAs

The conference agreement increases the AGI phase-out limits for Roth IRAs to $200,000–$210,000 for joint filers and to $100,000–$110,000 for all other filers.

The conference agreement increases the Roth IRA AGI conversion limit to $200,000 for joint filers ($100,000 for all other filers).

IRA investments in coins

The conference agreement does not include the Senate amendment.

Deemed IRAs under employer plans

The conference agreement follows the Senate amendment.

Effective date

The conference agreement generally is effective for years beginning after December 31, 2000. The provisions increasing the AGI phase-out limits for Roth IRAs and the Roth IRA AGI conversion limit are effective for years beginning after December 31, 2002.

H. Creation of Individual Development Accounts (sec. 304 of the Senate amendment, and new sec. 530A of the Code)

Present Law

There are no tax benefits to encourage financial institutions to match savings of low-income individuals.

House Bill

No provision.

Senate Amendment

In general

The Senate amendment creates individual development accounts ("IDAs") to which eligible individuals can contribute. In addition, the Senate amendment provides a tax credit for certain matching contributions made to an IDA by the financial institution maintaining the IDA. Eligible individuals are individuals who are: (1) at least 18 years of age; (2) a citizen or legal resident of the United States; and (3) a member of a household eligible for the earned income credit, Temporary Assistance for Needy Families ("TANF"), or with family gross income of 60 percent or less of area median gross income and net worth of $10,000 or less.

Contributions to an IDA by eligible individuals

Only eligible individuals are allowed to contribute to an IDA. Contributions to IDAs by individuals are not deductible, and earnings on such contributions are includible in income. The maximum contribution that can be made to an IDA for a taxable year is the lesser of (1) $350 or (2) the individual's taxable compensation for the year. A special rule would allow contributions of up to $350 for each spouse in a married couple if the total compensation of the spouses is at least equal to the amount contributed.

Matching contributions

The Senate amendment provides a tax credit to financial institutions that make matching contributions to IDAs of individuals.[11] The tax credit equals 85 percent of matching contributions, rounded up to the nearest $10, up to a maximum annual credit of $300 per eligible individual. The credit is available in each year that a matching contribution is made.

Matching contributions (and earnings thereon) are not includible in the gross income of the eligible individual.

If an individual withdraws his or her own IDA contributions (or earnings thereon) for a purpose other than a qualified purpose, the matching contribution attributable to such individual contribution is forfeited.[12] Matching contributions may be withdrawn only in a qualified purpose distribution.

A qualified purpose distribution is a distribution (1) that is made after the individual has completed an economic literacy course, (2)

[11] Matching contributions (and earnings) are accounted for separately from individual IDA contributions (and earnings).

[12] The financial institution is to use forfeited amounts to make other matching contributions. No credit is provided with respect to such reallocated contributions.

that is made by the financial institution directly to the person to whom the funds are to (or to another IDA) and (3) is used for (a) certain educational expenses, (b) first-time homebuyer expenses, and (c) business start-up expenses.

Effect on means-tested programs

Any amounts in the IDA are not to be taken into account for certain Federal means-tested programs.

Effective date

The provision is effective for contributions to IDAs and matching contributions made with respect to such IDAs after December 31, 2000, and before January 1, 2006.

Conference Agreement

The conference agreement does not include the Senate amendment.

III. BUSINESS INVESTMENT AND JOB CERTAIN PROVISIONS

A. Alternative Tax for Corporate Capital Gains (sec. 301 of the House bill and sec. 1201 of the Code)

Present Law

Under present law, the net capital gain of a corporation is taxed at the same rates as ordinary income, and subject to tax at graduated rates up to 35 percent.

House Bill

Under the House bill, an alternative tax rate of 30 percent applies to the net capital gain of a corporation if that tax is lower than the corporation's regular tax.

Effective date.—The provision applies to taxable years beginning after December 31, 2004.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not contain the provision in the House bill.

B. Corporate Alternative Minimum Tax (sec. 302(a) of the House bill, sec. 1103 of the Senate amendment and secs. 53 and 56 of the Code)

Present Law

In general

Present law imposes a minimum tax on a corporation to the extent the corporation's minimum tax liability exceeds its regular tax liability. This alternative minimum tax ("AMT") is imposed on

corporations at the rate of 20 percent on the alternative minimum taxable income ("AMTI") in excess of a $40,000 phased-out exemption amount. The exemption amount is phased-out by an amount equal to 25 percent of the amount that the corporation's AMTI exceeds $150,000.

AMTI is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

A corporation with average gross receipts of less that $7.5 million for the prior three taxable years is exempt from the corporate minimum tax. The $7.5 million threshold is reduced to $5 million for the corporation's first 3-taxable year period.

Preference items in computing AMTI

The corporate minimum tax preference items are:

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

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to an independent producer to the extent the preference would not reduce the producer's AMTI by more than 40 percent.

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

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

Adjustments in computing AMTI

The adjustments that corporations must make in computing AMTI are:

(1) Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence.

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

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

(4) The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31,

1998, is calculated using the regular tax recovery periods and the straight-line method.

(5) The special rules applicable to Merchant Marine construction funds are not applicable.

(6) The special deduction allowable under section 833(b) for Blue Cross and Blue Shield organizations is not allowed.

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

Adjusted current earning ("ACE") adjustment

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

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

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

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

(4) Intangible drilling costs of integrated oil companies must be capitalized and amortized over a 60-month period.

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

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

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

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

(9) Depletion (other than for oil and gas) must be calculated using the cost, rather than the percentage, method.

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

Other rules

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

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

If a corporation is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in such subsequent year.

House Bill

For taxable years beginning in 2005, the limitation on the amount of AMT credits allowable to a corporation will be increased by 20 percent of the corporation's tentative minimum tax. This percentage is raised to 30, 40 and 50 percent, respectively, for 2006, 2007 and 2008. The AMT credit may not exceed an amount equal to the sum of the regular tax and minimum tax less the other nonrefundable credits.

For taxable years beginning after 2008, the provision repeals the corporate AMT. A corporation then will be allowed to use the AMT credit to offset 90 percent of its regular tax liability (determined after the application of other nonrefundable credits).

Effective dates.—The provision allowing the AMT credit to be offset a portion of the minimum tax applies to taxable years beginning after December 31, 2004.

The provision repealing the AMT applies to taxable years beginning after December 31, 2008.

Senate Amendment

The Senate amendment allows a corporation with long-term AMT credits to use the AMT credit to offset a portion of its tentative minimum tax. The portion so allowed is the least of: (1) the amount of the corporation's long-term minimum tax credit; (2) 50 percent of the corporation's tentative minimum tax; or (3) the amount by which the corporation's tentative minimum tax exceeds its regular tax for the taxable year.

Under the amendment, an AMT credit is a long-term minimum tax credit if the credit is attributable to the adjusted net minimum tax of the corporation for a taxable year that began after 1986 and ended before the fifth taxable year immediately preceding the taxable year for which the determination is being made.

Effective date.—The provision applies to taxable years beginning after December 31, 2003.

Conference Agreement

The conference agreement allows a corporation to increase the use of minimum tax credits to the extent of the lesser of 50 percent of the tentative minimum tax for the taxable year or the excess (if any) of the tentative minimum tax over the regular tax for the taxable year.

The conference agreement also allows a corporation to use AMT net operating loss deductions to offset 100 percent (rather than 90 percent) of the AMTI.

Effective dates.—The credit provision applies to taxable years beginning after December 31, 2004. The net operating deduction provision applies to taxable years beginning after December 31, 2001.

C. Repeal of Limitation of Foreign Tax Credit Under Alternative Minimum Tax (sec. 302(b) of the House bill, sec. 907 of the Senate amendment, and sec. 59 of the Code)

Present Law

Under present law, taxpayers are subject to an alternative minimum tax ("AMT"), which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax liability. The tax is imposed at a flat rate of 20 percent, in the case of corporate taxpayers, on alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount. The maximum rate for noncorporate taxpayers is 28 percent. AMTI is the taxpayer's taxable income increased for certain tax preferences and adjusted by determining the tax treatment of certain items in a manner which negates the exclusion or deferral of income resulting from the regular tax treatment of those items.

Taxpayers are permitted to reduce their AMT liability by an AMT foreign tax credit. The AMT foreign tax credit for a taxable year is determined under principles similar to those used in computing the regular tax foreign tax credit, except that (1) the numerator of the AMT foreign tax credit limitation fraction is foreign source AMTI and (2) the denominator of that fraction is total AMTI.[13] Taxpayers may elect to use as their AMT foreign tax credit limitation fraction the ratio of foreign source *regular* taxable income to total AMTI (sec. 59(a)(4)).

The AMT foreign tax credit for any taxable year generally may not offset a taxpayer's entire pre-credit AMT. Rather, the AMT foreign tax credit is limited to 90 percent of AMT computed without an AMT net operating loss deduction, an AMT energy preference deduction, or an AMT foreign tax credit. For example, assume that a corporation has $10 million of AMTI from foreign sources, has no AMT net operating loss or energy preference deductions, and is subject to the AMT. In the absence of the AMT foreign tax credit, the corporation's tax liability would be $2 million. Accordingly, the AMT foreign tax credit cannot be applied to reduce the taxpayer's tax liability below $200,000. Any unused AMT foreign tax credit may be carried back 2 years and carried forward 5 years for use against AMT in those years under the principles of the foreign tax credit carryback and carryforward rules set forth in section 904(c).

House Bill

The House bill repeals the 90-percent limitation on the utilization of the AMT foreign tax credit.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

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[13] Similar to the regular tax foreign tax credit, the AMT foreign tax credit is subject to the separate limitation categories set forth in section 904(d). Under the AMT foreign tax credit, however, the determination of whether any income is high taxed for purposes of the high-tax-kick-out rules (sec. 904(d)(2)) is made on the basis of the applicable AMT rate rather than the highest applicable rate of regular tax.

Senate Amendment

The Senate amendment is the same as the House bill, with a modification to the effective date.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

Conference Agreement

The conference agreement follows the House bill.

IV. EDUCATION TAX RELIEF PROVISIONS

A. Student Loan Interest Deduction (secs. 112 and 406 of the House bill, sec. 401 of the Senate amendment, and sec. 221 of the Code)

Present Law

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.[14] The deduction is phased out ratably for individual taxpayers with modified adjusted gross income ("AGI") of $40,000–$55,000 and $60,000–$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

House Bill

The House bill increases the beginning point of the income phaseout for the student loan interest deduction for taxpayers filing joint returns to twice the beginning point of the income phase-

[14] The maximum allowable deduction for 1998 was $1,000.

outs applicable to single taxpayers and doubles the phaseout range for joint filers. The House bill also repeals both the limit on the number of months during which interest paid on a qualified education loan is deductible and the restriction that nonmandatory payments of interest are not deductible.

Effective date.—The House bill generally is effective for taxable years beginning after December 31, 1999. The House bill provision repealing the 60-month limit on deductible student loan interest is effective for interest paid on qualified education loans after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill, except that it increases the beginning point of the income phaseout for the student loan interest deduction for individual taxpayers from $40,000 to $50,000 and does not double the phaseout range for joint filers. Like the House bill, the Senate amendment increases the beginning point of the income phaseout for taxpayers filing joint returns to twice the beginning point of the income phaseouts applicable to single taxpayers.

Effective date.—The Senate amendment generally is effective generally for taxable years ending after December 31, 1999. The Senate amendment provision repealing the 60-month limit on deductible student loan interest is effective for interest paid on qualified education loans after December 31, 1999, in taxable years ending after such date.

Conference Agreement

The conference agreement follows the Senate amendment, with the modification that the beginning point of the income phaseout for individual taxpayers is $45,000. Thus, beginning in 2000, the deduction will be phased out ratably for individual taxpayers with modified AGI of $45,000 to $60,000 and for taxpayers filing joint returns with modified AGI of $90,000–$105,000.

B. Expand Education Savings Accounts (sec. 401 of the House bill and secs. 530 and 4973 of the Code)

Present Law

In general

Section 530 provides tax-exempt status to education individual retirement accounts ("education IRAs"), meaning certain trusts (or custodial accounts) which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a named beneficiary.[15] Contributions to education IRAs may be made only in cash. Annual contributions to education IRAs may not exceed $500 per designated beneficiary (except in cases involving certain tax-free rollovers, as described below), and may not be made after the designated beneficiary

[15] Education IRAs generally are not subject to Federal income tax, but are subject to the unrelated business income tax ("UBIT") imposed by section 511.

reaches age 18.[16] Moreover, an excise tax is imposed if a contribution is made by any person to an education IRA established on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program (defined under sec. 529) on behalf of the same beneficiary.

Phase-out of contribution limit

The $500 annual contribution limit for education IRAs is phased out ratably for contributors with modified adjusted gross income ("AGI") between $95,000 and $110,000 (between $150,000 and $160,000 for joint returns). Individuals with modified AGI above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any individual.

Treatment of distributions

Amounts distributed from an education IRA are excludable from gross income to the extent that the amounts distributed do not exceed qualified higher education expenses of the designated beneficiary incurred during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed with respect to the beneficiary for the same taxable year). Distributions from an education IRA are generally deemed to consist of distributions of principal (which, under all circumstances, are excludable from gross income) and earnings (which may be excludable from gross income) by applying the ratio that the aggregate amount of contributions to the account for the beneficiary bears to the total balance of the account. If the qualified higher education expenses of the student for the year are at least equal to the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the earnings in their entirety are excludable from gross income. If, on the other hand, the qualified higher education expenses of the student for the year are less than the total amount of the distribution (i.e., principal and earnings combined) from an education IRA, then the qualified higher education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings are excludable (i.e., a portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includible in the distributee's gross income.

To the extent that a distribution exceeds qualified higher education expenses of the designated beneficiary, an additional 10-percent tax is imposed on the earnings portion of such excess distribution, unless such distribution is made on account of the death or disability of, or scholarship received by, the designated beneficiary. The additional 10-percent tax also does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was

[16] An excise tax may be imposed under present law to the extent that excess contributions above the $500 annual limit are made to an education IRA.

made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

Present law allows tax-free transfers or rollovers of account balances from one education IRA benefitting one beneficiary to another education IRA benefitting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary. For this purpose, a "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws—and any spouse of such persons or of the original beneficiary.

Any balance remaining in an education IRA is deemed to be distributed within 30 days after the date that the named beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses

The term "qualified higher education expenses" includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis. Moreover, the term "qualified higher education expenses" includes certain room and board expenses for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Qualified higher education expenses generally include only out-of-pocket expenses. Such qualified higher education expenses do not include expenses covered by educational assistance for the benefit of the beneficiary that is excludable from gross income. Thus, total qualified higher education expenses are reduced by scholarship or fellowship grants excludable from gross income under present-law section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance that is excludable from the employee's gross income under section 127.[17]

Present law also provides that, if any qualified higher education expenses are taken into account in determining the amount of the exclusion for a distribution from an education IRA, then no deduction (e.g., for trade or business expenses deductible under sec. 162), or exclusion (e.g., for expenses paid with interest on education savings bonds excludable under sec. 135), or credit is allowed with respect to such expenses.

[17] No reduction of qualified higher education expenses is required, however, for a gift, bequest, devise, or inheritance.

Eligible educational institution

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

House Bill

Annual contribution limit

The House bill increases the annual education IRA contribution limit to $2,000. Thus, in years beginning after 2000, aggregate contributions that can be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary are limited to $2,000 for each year.

Qualified expenses

The House bill expands the definition of qualified education expenses that may be paid with tax-free distributions from an education IRA for distributions made in taxable years beginning after December 31, 2000. Specifically, the definition of qualified education expenses is expanded to include "qualified elementary and secondary education expenses," meaning (1) tuition, fees, academic tutoring, special needs services, books, supplies, and equipment (including computers and related software and services) incurred in connection with the enrollment or attendance of the designated beneficiary as an elementary or secondary student at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12), and (2) room and board, uniforms, transportation, and supplementary items and services (including extended-day programs) required or provided by such a school in connection with such enrollment or attendance of the designated beneficiary.[18] "Qualified elementary and secondary education expenses" also include certain homeschooling education expenses if the requirements of any applicable State or local law are met with respect to such homeschooling.

Under the House bill, the definition of "qualified higher education expenses" is modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible education institution, and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies determined by the educational institution for purposes of Federal financial assistance programs).[19] The House bill also provides that

[18] Contributions made to education IRAs prior to December 31, 2000, (and earnings thereon) may be used for distributions for qualified elementary and secondary education expenses made after January 1, 2001. Thus, it is not necessary for trustees of education IRAs to keep separate accounts with respect to contributions made prior to January 1, 2001, and earnings thereon.

[19] "Qualified higher education expenses" for purposes of education IRAs are defined by reference to the definition of such expenses for purposes of qualified State tuition programs (sec.

"qualified higher education expenses" does not include expenses for education involving sports, games, or hobbies unless this education is part of the student's degree program or is taken to acquire or improve job skills of the individual. The House bill does not change the definition of "qualified higher education expenses" with respect to expenses for room and board.

Special needs beneficiaries

The House bill also provides that, although contributions to an education IRA generally may not be made after the designated beneficiary reaches age 18, contributions may continue to be made to an education IRA in the case of a special needs beneficiary (as defined by Treasury Department regulations). In addition, under the House bill, in the case of a special needs beneficiary, a deemed distribution of any balance in an education IRA will not occur when the beneficiary reaches age 30.

Contributions by persons other than individuals

The House bill clarifies that corporations and other entities (including tax-exempt organizations) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution. As under present law, the eligibility of high-income individuals to make contributions to education IRAs is phased out ratably for individuals with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for joint returns).

Contributions permitted until April 15

Under the House bill, individual contributors to education IRAs are deemed to have made a contribution 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), generally April 15.[20] The House bill also provides that the additional 10-percent tax does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the first day of the sixth month of the taxable year (generally June 1) following the taxable year during which the contribution was or was deemed made.

Coordination with HOPE and Lifetime Learning credits

For distributions made after December 31, 2000, the House bill allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.

530(b)(2)(A)). Because the House bill modifies the definition of "qualified higher education expenses" for purposes of qualified State tuition programs (sec. 529(e)(3)), the definition of "qualified higher education expenses" for education IRAs is also modified.

[20] Trustees of education IRAs will require documentation from a contributor (whether an individual, corporation, or other entity) indicating the taxable year to which the contribution should be allocated.

Coordination with qualified tuition programs

The House bill repeals the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary (sec. 4973(e)(1)(B)).

Change name to "Education Savings Accounts"

The House bill changes the name of education IRAs to "Education Savings Accounts."

Effective date

The House bill provisions modifying education IRAs generally are effective for taxable years beginning after December 31, 2000. The House bill provision modifying the definition of "qualified higher education expenses" applies to amounts paid for education furnished after December 31, 1999, the same date that this provision is effective for qualified state tuition plans described in section 529. The House bill provision changing the name of education IRAs to Education Savings Accounts is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

C. Allow Tax-free Distributions From State and Private Education Programs (sec. 402 of the House bill, sec. 402 of the Senate amendment, and sec. 529 of the Code)

Present Law

Section 529 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 (a "savings account plan"). The term "qualified higher education expenses" generally has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution,[21] as well as certain room and board expenses for any period during which the student is at least a half-time student.

No amount is included in the gross income of a contributor to, or beneficiary of, a qualified State tuition program with respect to

[21] "Eligible educational institutions" are defined the same for purposes of education IRAs and qualified State tuition programs.

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) are 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) are included in the contributor's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.[22]

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.[23] Contributors and beneficiaries are not allowed to directly or indirectly direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships. A transfer of credits (or other amounts) from one account benefitting one designated beneficiary to another account benefitting a different beneficiary is considered a distribution (as is a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family. For this purpose, the term "member of the family" means persons described in paragraphs (1) through (8) of section 152(a)—e.g., sons, daughters, brothers, sisters, nephews and nieces, certain in-laws—and any spouse of such persons or of the original beneficiary. Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

To the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f)(1)), the distributee (or another taxpayer claiming the distributee as a dependent) may claim the HOPE credit or Lifetime Learning credit under section 25A with respect to such tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning

[22] Distributions from qualified State tuition programs are treated as representing a pro-rata share of the principal (i.e., contributions) and accumulated earnings in the account.

[23] Sections 529(c)(2), (c)(4), and (c)(5), and section 530(d)(3) provide special estate and gift tax rules for contributions made to, and distributions made from, qualified State tuition programs and education IRAs.

credit are satisfied and the modified AGI phaseout for those credits does not apply).

House Bill

Qualified tuition program

The House bill expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private educational institutions, persons will be able to purchase tuition credits or certificates on behalf of a designated beneficiary (as described in section 529(b)(1)(A)(i)), but will not be able to make contributions to a savings account plan (described in section 529(b)(1)(A)(ii)).

Exclusion from gross income

Under the House bill, an exclusion from gross income is provided for distributions made in taxable years beginning after December 31, 2000, from qualified State tuition programs to the extent that the distribution is used to pay for qualified higher education expenses. This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a State or agency or instrumentality thereof, for distributions made in taxable years after December 31, 2003.

The House bill also allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed.

Definition of qualified higher education expenses

Under the House bill, the definition of "qualified higher education expenses" is modified to mean: (1) tuition and fees required for the enrollment or attendance of a designated beneficiary at an eligible educational institution, and (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance (but not in excess of the allowance for books and supplies determined by the educational institution for purposes of Federal financial assistance programs).[24] The House bill also provides that "qualified higher education expenses" will not include expenses for education involving sports, games, or hobbies unless this education is part of the student's degree program or is taken to acquire or improve job skills of the individual. The bill does not

[24] The conferees intend that, with respect to a distribution made from a qualified tuition program that does not exceed the allowance for books and supplies determined for purposes of Federal financial assistance by the eligible educational institution where the beneficiary is enrolled, Treasury regulations will provide that beneficiaries need not substantiate actual purchases of books, supplies, and equipment.

change the definition of "qualified higher education expenses" with respect to expenses for room and board.

Rollovers for benefit of same beneficiary

The House bill provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary will not be considered a distribution for a maximum of one such transfer in each 1-year period.

Member of family

The House bill further provides that, for purposes of tax-free rollovers and changes of designated beneficiaries, a "member of the family" includes first cousins of such beneficiary.

Effective date

The House bill provision permitting the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 2000. The exclusion from gross income for certain distributions from qualified State tuition programs under section 529 is effective for distributions made in taxable years beginning after December 31, 2000. In the case of a qualified tuition program established and maintained by an entity other than a State or agency or instrumentality thereof, the House bill provision allowing an exclusion from gross income for certain distributions is effective for distributions made in taxable years beginning after December 31, 2003. The House bill provision coordinating distributions from qualified tuition programs with the HOPE and Lifetime Learning credits is effective for distributions made after December 31, 2000. The House bill provision modifying the definition of qualified higher education expenses is effective for amounts paid for education furnished after December 31, 1999. The House bill provisions allowing rollovers for the same beneficiary and including first cousins as a member of the family are effective for taxable years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill, except that it provides for coordination of the HOPE credit or Lifetime Learning credit with distributions from education individual retirement accounts ("education IRAs") (in addition to distributions from qualified tuition plans) as long as the distributions are not used for the same expenses for which a credit was claimed. The Senate amendment also provides that the section may be cited as the "Collegiate Learning and Student Savings (CLASS) Act."

Effective date.—The Senate amendment provision permitting the establishment of qualified tuition programs maintained by one or more private educational institutions is effective for taxable years beginning after December 31, 1999. The exclusion from gross income for certain distributions from qualified State tuition programs under section 529 is effective for distributions made in taxable years beginning after December 31, 1999. In the case of a qualified tuition program established and maintained by an entity

other than a State or agency or instrumentality thereof, the Senate amendment provision allowing an exclusion from gross income for certain distributions is effective for distributions made in taxable years beginning after December 31, 2003. The Senate amendment provision coordinating distributions from qualified tuition programs and education IRAs with the HOPE and Lifetime Learning credits is effective for distributions made after December 31, 1999. The Senate amendment provision modifying the definition of qualified higher education expenses is effective for amounts paid for courses beginning after December 31, 1999. The provisions allowing rollovers for the same beneficiary and including first cousins as a member of the family is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment, except that the provision coordinating the HOPE and Lifetime Learning credits with distributions from education IRAs is not included because this provision is included in the conference agreement provision for education IRAs.

D. Eliminate Tax on Awards under National Health Service Corps Scholarship Program, F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program, National Institutes of Health Undergraduate Scholarship Program, and Certain State-Sponsored Scholarship Programs (sec. 403 of the House bill and the Senate amendment and sec. 117 of the Code)

Present Law

Section 117 excludes from gross income qualified scholarships received by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations.

Section 117(c) specifically provides that the exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction.

The National Health Service Corps Scholarship Program (the "NHSC Scholarship Program"), the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the "Armed Forces Scholarship Program"), and the National Institutes of Health Undergraduate Scholarship Program (the "NIH Scholarship Program") provide education awards to par-

ticipants on condition that the participants provide certain services. In the case of the NHSC Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health-care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility. The National Institutes of Health Undergraduate Scholarship Program (the "NIH Scholarship Program") awards scholarships to students from disadvantaged backgrounds interested in pursuing a career in biomedical research. In exchange, the recipients must work for the National Institutes of Health after graduation. Several States also provide a limited number of scholarships to students in health professions who are obligated to work in underserved areas for a period of time after graduation. Because the recipients of scholarships in all of these programs are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

House Bill

The House bill provides that amounts received by an individual under the NHSC Scholarship Program, the Armed Forces Scholarship Program, the NIH Scholarship Program, or any State-sponsored health scholarship program determined by the Secretary of the Treasury to have substantially similar objectives to these programs are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students for regular living expenses, including room and board.

Effective date.—The House bill is effective for education awards received under the NHSC Scholarship Program, the Armed Forces Scholarship Program, and the NIH Scholarship Program after December 31, 1993. The House bill is effective for education awards received under any State-sponsored health scholarship program designated by the Secretary of the Treasury after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill, except that it does not extend the exclusion from gross income to the NIH Scholarship Program or State-sponsored health scholarship programs.

Conference Agreement

The conference agreement follows the House bill.

E. Exclusion for Employer-Provided Educational Assistance (sec. 404 of the Senate amendment and sec. 127 of the Code)

Present Law

Educational expenses paid by an employer for its employees are generally deductible to the employer.

Employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under a section 127 educational assistance plan or if the expenses qualify as a working condition fringe benefit under section 132. Section 127 provides an exclusion of $5,250 annually for employer-provided educational assistance. The exclusion does not apply to graduate courses. The exclusion for employer-provided educational assistance expires with respect to courses beginning on or after June 1, 2000.

In order for the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The educational assistance program must not discriminate in favor of highly compensated employees. In addition, not more than 5 percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance plan can be provided for the class of individuals consisting of more than 5-percent owners of the employer (and their spouses and dependents).

Educational expenses that do not qualify for the section 127 exclusion may be excludable from income as a working condition fringe benefit.[25] In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business.[26]

House Bill

No provision.

Senate Amendment

The provision extends the exclusion for employer-provided educational assistance through 2003, thus, the exclusion is not available with respect to courses beginning after December 31, 2003. The provision also extends the exclusion to graduate education, effective for courses beginning on or after January 1, 2000, and before January 1, 2004.

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[25] These rules also apply in the event that section 127 expires and is not reinstated.

[26] In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses, along with other miscellaneous deductions, exceed 2 percent of the taxpayer's AGI. The 2-percent floor limitation is disregarded in determining whether an item is excludable as a working condition fringe benefit.

Effective date.—The provision is generally effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with respect to the extension of the exclusion as applied to undergraduate education, but does not include the extension of the exclusion to graduate education.

F. Liberalize Tax-Exempt Financing Rules for Public School Construction (secs. 404–405 of the House bill, secs. 405–407 of the Senate amendment, and secs. 103, 148, and 149 of the Code)

Present Law

Tax-exempt bonds

In general

Interest on debt incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103). Like other activities carried out and paid for by States and local governments, the construction, renovation, and operation of public schools is an activity eligible for financing with the proceeds of tax-exempt bonds.

Interest on bonds that nominally are issued by States or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue Act. These bonds are called "private activity bonds." The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

The Code includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code—including elementary, secondary, and post-secondary schools—may be financed with tax-exempt private activity bonds ("qualified 501(c)(3) bonds").

In most cases, the volume of tax-exempt private activity bonds is restricted by aggregate annual limits imposed on bonds issued by issuers within each State. These annual volume limits equal $50 per resident of the State, or $150 million if greater. The annual State private activity bond volume limits are scheduled to increase to the greater of $75 per resident of the State or $225 million in calendar year 2007. The increase will be phased in ratably beginning in calendar year 2003. This increase was enacted by the Tax and Trade Relief Extension Act of 1998. Qualified 501(c)(3) bonds

are among the tax-exempt private activity bonds that are not subject to these volume limits.

Private activity tax-exempt bonds may not be used to finance schools owned or operated by private, for-profit businesses.

Arbitrage restrictions on tax-exempt bonds

The Federal income tax does not apply to income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than necessary, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds. In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods") before funds are needed for the purpose of the borrowing or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, investment profits that are earned during these periods or on such investments must be rebated to the Federal Government.

The Code includes three exceptions applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance. In the case of governmental bonds (including bonds to finance public schools) the six-month expenditure exception is treated as satisfied if at least 95 percent of the proceeds is spent within six months and the remaining five percent is spent within 12 months after the bonds are issued.

Second, in the case of bonds to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months for construction proceeds. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24-month period and prescribed intermediate spending percentages are satisfied.

Third, governmental bonds issued by "small" governments are not subject to the rebate requirement. Small governments are defined as general purpose governmental units that issue no more than $5 million of tax-exempt governmental bonds in a calendar year. The $5 million limit is increased to $10 million if at least $5 million of the bonds are used to finance public schools.

Restriction on Federal guarantees of tax-exempt bonds

Unlike interest on State or local government bonds, interest on Federal debt (e.g., Treasury bills) is taxable. Generally, interest on State and local government bonds that are Federally guaranteed does not qualify for tax-exemption. This restriction was enacted in 1984. The 1984 legislation included exceptions for housing bonds and for certain other Federal insurance programs that were in existence when the restriction was enacted.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, certain States and local governments are given the authority to issue "qualified zone academy bonds." Under present law, a total of $400 million of qualified zone academy bonds may be issued in each of 1998 and 1999. The $400 million aggregate bond authority is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit to qualified zone academies within such State. A State may carry over any unused allocation into subsequent years.

1. Increase amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

House Bill

The additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirement is increased from $5 million to $10 million. Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year provided that at least $10 million of the bonds are used to finance public school construction expenditures.

Effective date.—The provision is effective for bonds issued in calendar years beginning after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Liberalize construction bond expenditure rule for governmental bonds for public schools

House Bill

The present-law 24-month expenditure exception to the arbitrage rebate requirement are liberalized for certain public school bonds. Under the bill, no rebate is required with respect to earnings on available construction proceeds of public school bonds if the proceeds are spent within 48 months after the bonds are issued and the following intermediate spending levels are satisfied:

12 months	At least 10 percent.
24 months	At least 30 percent.
12 months	At least 10 percent.
36 months	At least 60 percent.
48 months	100 percent (less present-law retainage amounts which must be spent within 60 months of issuance).

Effective date.—The provision applies to bonds issued in calendar years beginning after 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Allow issuance of tax-exempt private activity bonds for public school facilities

House Bill

No provision.

Senate Amendment

The private activities for which tax-exempt bonds may be issued are expanded to include elementary and secondary public school facilities which are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events) and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes or equips a school facility. The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State volume limit equal to the greater of $10 per resident ($5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States decide how to allocate the bond authority to State and local government agencies. Bond authority that is unused in the year in which it arises may be carried forward for up to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

Effective date.—The provision applies to bonds issued after December 31, 1999.

Conference Agreement

The conference does not include the Senate amendment provision.

4. Permit limited Federal guarantees of school construction bonds by the Federal Housing Finance Board

House Bill

No provision.

Senate Amendment

The Federal Housing Finance Board is permitted to authorize the regional Federal Home Loan Banks in its system to guarantee limited amounts of public school bonds. Eligible bonds are governmental bonds with respect to which 95 percent of more of the proceeds are used for public school construction. The aggregate amount of bonds which may be guaranteed by all such Banks pursuant to this provision is $500 million per year.

Effective date.—The provision will become effective upon enactment (after the date of enactment of the amendment) of legislation authorizing the Federal Housing Finance Board and Federal Home Loan Banks to provide the guarantees.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

G. Expansion of Deduction for Computer Donations to Schools (sec. 1124 of the Senate amendment and sec. 170(e)(6) of the Code)

Present Law

The maximum charitable contribution deduction that may be claimed by a corporation for any one taxable year is limited to 10 percent of the corporation's taxable income for that year (disregarding charitable contributions and with certain other modifications) (sec. 170(b)(2)). Corporations also are subject to certain limitations based on the type of property contributed. In the case of a charitable contribution of short-term gain property, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis (generally, cost) in the property. However, special rules in the Code provide an augmented deduction for certain corporate contributions. Under these special rules, the amount of the augmented deduction is equal to the lesser of (1) the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or (2) twice basis.

Section 170(e)(6) allows corporate taxpayers an augmented deduction for qualified contributions of computer technology and equipment (i.e., computer software, computer or peripheral equipment, and fiber optic cable related to computer use) to be used within the United States for educational purposes in grades K–12. Eligible donees are: (1) any educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly carried on; and (2) tax-exempt charitable organizations that are organized primarily for purposes

of supporting elementary and secondary education. A private foundation also is an eligible donee, provided that, within 30 days after receipt of the contribution, the private foundation contributes the property to an eligible donee described above.

Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. In addition, the original use of the donated property must commence with the donor or the donee. Accordingly, qualified contributions generally are limited to property that is no more than two years old. Such donated property could be computer technology or equipment that is inventory or depreciable trade or business property in the hands of the donor.

Donee organizations are not permitted to transfer the donated property for money or services (e.g., a donee organization cannot sell the computers). However, a donee organization may transfer the donated property in furtherance of its exempt purposes and be reimbursed for shipping, installation, and transfer costs. For example, if a corporation contributes computers to a charity that subsequently distributes the computers to several elementary schools in a given area, the charity could be reimbursed by the elementary schools for shipping, transfer, and installation costs.

The special treatment applies only to donations made by C corporations; S corporations, personal holding companies, and service organizations are not eligible donors.

The provision is scheduled to expire for contributions made in taxable years beginning after December 31, 2000.

House Bill

No provision.

Senate Amendment

The Senate amendment makes the augmented deduction of section 170(e)(6) available for gifts made no later than three years after the date the taxpayer acquired or substantially completed the construction of the donated property. The Senate amendment also modifies the current-law original use requirement (i.e., the original use of the donated property must be the donor or the donee) by making the deduction available to donors who reacquire computers prior to donation. Thus, a corporation would be permitted to donate computers that were traded in or returned to them under a lease program.

Effective date.—The Senate amendment is effective for contributions made in taxable years ending after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

H. Credit for Computer Donations to Schools and Senior Centers (sec. 1125 of the Senate amendment and new sec. 45E of the Code)

Present Law

The maximum charitable contribution deduction that may be claimed by a corporation for any one taxable year is limited to 10 percent of the corporation's taxable income for that year (disregarding charitable contributions and with certain other modifications) (sec. 170(b)(2)). Corporations also are subject to certain limitations based on the type of property contributed. In the case of a charitable contribution of short-term gain property, inventory, or other ordinary income property, the amount of the deduction generally is limited to the taxpayer's basis (generally, cost) in the property. However, special rules in the Code provide an augmented deduction for certain corporate contributions. Under these special rules, the amount of the augmented deduction is equal to the lesser of (1) the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or (2) twice basis.

Section 170(e)(6) allows corporate taxpayers an augmented deduction for qualified contributions of computer technology and equipment (i.e., computer software, computer or peripheral equipment, and fiber optic cable related to computer use) to be used within the United States for educational purposes in grades K–12. Qualified contributions are limited to gifts made no later than two years after the date the taxpayer acquired or substantially completed the construction of the donated property. In addition, the original use of the donated property must commence with the donor or the donee. Eligible donees are: (1) any educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly carried on; and (2) tax-exempt charitable organizations that are organized primarily for purposes of supporting elementary and secondary education. A private foundation also is an eligible donee, provided that, within 30 days after receipt of the contribution, the private foundation contributes the property to an eligible donee described above.

House Bill

No provision.

Senate Amendment

The Senate amendment permits businesses to claim a tax credit in lieu of the augmented deduction for qualified contributions of computer technology and equipment, as defined under section 170(e)(6)(B).[27] In addition, the Senate amendment allows businesses to claim a credit for contributions of computer technology or equipment to multipurpose senior centers (as defined by reference

[27] In addition, the Senate amendment provides that the term "qualified computer contribution," for purposes of the computer donation credit, includes a computer only if the computer software that serves as the computer's operating system has been lawfully installed.

to the Older Americans Act of 1965) for use by individuals who are at least 60 years old to improve job skills in computers.

The credit is equal to 30 percent of the amount calculated for purposes of determining the augmented deduction under section 170(e)(6)(A) (i.e., the lesser of the basis of the donated property plus one-half of the amount of ordinary income that would have been realized if the property had been sold, or twice basis). If the donee is a qualified educational organization or senior center located in an empowerment zone, enterprise community, or Indian reservation (as defined in sec. 168(j)(6)), the proposed credit would be equal to 50 percent of the amount calculated for purposes of determining the augmented deduction under section 170(e)(6)(A). No deduction is allowed for the portion of computer donations made during a taxable year that is equal to the amount of the credit claimed during the year.

Effective date.—The Senate amendment provision providing a 30-percent credit for qualified computer donations is effective for contributions made in taxable years beginning one year after the date of enactment and before taxable years beginning on or after the date which is three years after the date of enactment. The Senate amendment provision providing a 50-percent credit for qualified computer donations to eligible recipients in empowerment zones, enterprise communities, and Indian reservations is effective for contributions made during taxable years beginning after the date of enactment and before taxable years beginning on or after the date which is three years after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

I. Two-Percent Floor Not To Apply to Professional Development Expenses of Teachers (sec. 1123 of the Senate amendment and sec. 67 of the Code)

Present Law

In general, taxpayers are not permitted to deduct education expenses. However, employees may deduct the cost of certain work-related education. For costs to be deductible, the education must either be required by the taxpayer's employer or by law to retain taxpayer's current job or be necessary to maintain or improve skills required in the taxpayer's current job. Expenses incurred for education that is necessary to meet minimum education requirements of an employee's present trade or business or that can qualify an employee for a new trade or business are not deductible.

An employee is allowed to deduct work-related education and other business expenses only to the extent such expenses (together with other miscellaneous itemized deductions) exceed 2 percent of the taxpayer's adjusted gross income.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that qualified professional development expenses incurred by an elementary or secondary school teacher (including instructors, aides, counselors and principals) with respect to certain courses of instruction would not be subject to the 2-percent floor on miscellaneous itemized deductions. Qualified professional development expenses are expenses for tuition, fees, books, supplies, equipment, and transportation required for enrollment or attendance in a qualified course of instruction, provided that such expenses are otherwise deductible under present law. A qualified course of instruction means a professional conference or a course of instruction at an institution of higher education (as defined in sec. 481 of the Higher Education Act of 1965), and which is part of a program of professional development that is approved and certified by the appropriate local educational agency as furthering the individual's teaching skills.

Additionally, the 2-percent floor would not apply to incidental expenses paid by an eligible teacher in an amount not greater than $125 for any taxable year for books, supplies and equipment related to instruction, teaching, or other educational job-related activities of the teacher. The exception to the 2-percent for incidental expenses would also apply to homeschooling if the requirements of applicable State or local law are met with respect to the homeschooling.

Effective date.—Taxable years beginning after December 31, 2000, and ending on or before December 31, 2004.

Conference Agreement

The conference agreement follows the Senate amendment with modifications. The conference agreement provides an exception to the 2-percent floor for the qualified professional development expenses of eligible teachers, not to exceed $1,000 per year. The conference agreement does not provide an exception to the 2-percent floor for job-related incidental expenses.

J. Exclusion for Education Benefits Provided by Employers to Children of Employees (sec. 404 of the Senate amendment and sec. 117 of the Code)

Present Law

If certain requirements are satisfied, employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under a section 127 educational assistance plan or if the expenses qualify as a working condition fringe benefit under section 132. Section 127 provides an exclusion of $5,250 annually for employer-provided educational assistance. The exclusion does not apply to graduate courses. The exclusion for employer-provided educational assistance expires with respect to courses beginning on or after June 1, 2000. These exclusions do not apply with respect to education provided to an individual other than the employee.

Section 117 provides that, if certain conditions are satisfied, a qualified scholarship is excludable from the gross income of an individual who is a candidate for a degree.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that educational benefits provided to children of employees are excludable from gross income as a scholarship, regardless of whether the child is a candidate for a degree program. Any such benefits must be in addition to any other compensation payable to the employee. The exclusion does not apply to any amount provided to a child of an individual who owns more than 5 percent of the employer.

The maximum amount excludable for a taxable year with respect to a child of an employee may not exceed $2,000. In addition, the maximum amount excludable from an employee's income for a year under the provision may not exceed the excess of the amount excludable under section 127 ($5,250) over the amount excluded from the employee's income under section 127 for that year.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

K. Credit for Interest on Higher Education Loans (sec. 208 of the Senate amendment and new sec. 25B of the Code)

Present Law

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit (sec. 221). The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include nonmandatory payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution con-

ducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable deduction per taxpayer return is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.[28] The deduction is phased out ratably for individual taxpayers with modified adjusted gross income ("AGI") of $40,000–$55,000 and $60,000–$75,000 for joint returns. The income ranges will be indexed for inflation after 2002.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, certain individuals who have paid interest on qualified education loans may claim a tax credit for such interest expenses, up to a maximum credit of $1,500 per year. The credit is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. A qualified education loan is defined in the same manner as for the deduction for student loan interest under section 221. No credit is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year. In addition, no credit is allowed for any amount taken into account for any deduction under chapter 1 of the Code.

The credit is phased out ratably for individual taxpayers with modified AGI of $50,000–$70,000 ($80,000–$100,000 for joint returns). The income phase-out ranges will be indexed for inflation after the year 2005, rounded to the closest multiple of $50.

Effective date.—The Senate amendment is effective for interest due and paid after December 31, 2004, on any qualified education loan.

Conference Agreement

The conference agreement does not include the Senate amendment.

V. HEALTH CARE TAX RELIEF PROVISIONS

A. Above-the-Line Deduction for Health Insurance Expenses (sec. 501 of the House bill and the Senate amendment and new sec. 222 of the Code)

Present Law

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed individual is 60 percent in 1999 through 2001; 70 percent in 2002; and 100 percent in 2003 and thereafter. The deduction for health

[28] The maximum allowable deduction for 1998 was $1,000.

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. The deduction applies to qualified long-term care insurance premiums treated as medical expenses under the itemized deduction for medical expenses, described below.

Employees can exclude from income 100 percent of employer-provided health insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may be taken into account for 1999 is as follows: $210 in the case of an individual 40 years old or less; $400 in the case of an individual who is more than 40 but not more than 50; $800 in the case of an individual who is more than 50 but not more than 60; $2,120 in the case of an individual who is more than 60 but not more than 70; and $2,660 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

House Bill

The House bill provides an above-the-line deduction for a percentage of the amount paid during the year for insurance which constitutes medical care (as defined under sec. 213, other than long-term care insurance treated as medical care under sec. 213) for the taxpayer and his or her spouse and dependents.[29] The deductible percentage is: 25 percent in 2001; 40 percent in 2002; 50 percent in 2003 through 2006; 75 percent in 2007; and 100 percent in 2008 and thereafter.

The deduction is not available to an individual for any month in which the individual is covered under an employer-sponsored health plan if at least 50 percent of the cost of the coverage is paid or incurred by the employer.[30] For purposes of this rule, any amounts excludable from the gross income of the employee under the exclusion for employer-provided health coverage is treated as paid or incurred by the employer; thus, for example, health insurance purchased by an employee through a cafeteria plan with salary reduction amounts is considered to be paid for by the employer.[31] In determining whether the 50-percent threshold is met, all health plans of the employer in which the employee participates are treated as a single plan. If the employer pays for less than 50 percent of the cost of all health plans in which the individual par-

[29] The deduction only applies to health insurance that constitutes medical care; it does not apply to medical expenses. The deduction applies to self-insured arrangements (provided such arrangements constitute insurance, e.g., there is appropriate risk-shifting) and coverage under employer plans treated as insurance under section 104. Another provision of the bill provides a similar deduction for qualified long-term care insurance expenses.

[30] This rule is applied separately with respect to qualified long-term care insurance.

[31] Excludable employer contributions to a health flexible spending arrangement or medical savings account (including salary reduction contributions) are also considered amounts paid by the employer for health insurance that constitutes medical care. Salary reduction contributions are not considered to be amounts paid by the employee.

ticipates, the deduction is available only with respect to each plan with respect to which the employer subsidy is less than 50 percent. Cost is determined as under the health care continuation rules.

The deduction is not available to individuals enrolled in Medicare, Medicaid, the Federal Employees Health Benefit Program ("FEHBP"),[32] Champus, VA, Indian Health Service, or Children's Health Insurance programs. Thus, for example, the deduction is not available with respect to Medigap coverage, because such coverage is provided to individuals enrolled in Medicare.

The provision authorizes the Secretary to prescribe rules necessary to carry out the provision, including appropriate reporting requirements for employers.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill, except that the deductible percentage of health care insurance expenses is as follows: 25 percent in 2001, 2002, and 2003; 50 percent in 2004 and 2005; and 100 percent in 2006 and thereafter.

In addition, under the Senate amendment, the deduction is not available with respect to insurance providing coverage for accidents, disability, dental care, vision care or a specific disease or making payments of a fixed amount per day (or other period) on account of hospitalization. Such insurance and employer payments for such insurance are not taken into account in determining whether the employee pays more than half the cost of the health insurance.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications to the deductible percentage.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

B. Provisions Relating to Long-Term Care Insurance (secs. 501 and 502 of the House bill, secs. 501 and 502 of the Senate amendment and secs. 105 and 125 and new sec. 222 of the Code)

Present Law

Tax treatment of health insurance and long-term care insurance

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed in-

[32] This rule does not prevent individuals covered by the FEHBP from deducting premiums for health care continuation coverage, provided the requirements for the deduction are otherwise met.

dividual is 60 percent in 1999 through 2001; 70 percent in 2002; and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse. The deduction applies to qualified long-term care insurance premiums treated as medical expenses under the itemized deduction for medical expenses, described below.

Employees can exclude from income 100 percent of employer-provided health insurance or qualified long-term care insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may be taken into account for 1999 is as follows: $210 in the case of an individual 40 years old or less; $400 in the case of an individual who is more than 40 but not more than 50; $800 in the case of an individual who is more than 50 but not more than 60; $2,120 in the case of an individual who is more than 60 but not more than 70; and $2,660 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

Cafeteria plans

Under present law, compensation generally is includible in gross income when actually or constructively received. An amount is constructively received by an individual if it is made available to the individual or the individual has an election to receive such amount. Under one exception to the general principle of constructive receipt, amounts are not included in the gross income of a participant in a cafeteria plan described in section 125 of the Code solely because the participant may elect among cash and certain employer-provided qualified benefits under the plan. This constructive receipt exception is not available if the individual is permitted to revoke a benefit election during a period of coverage in the absence of a change in family status or certain other events.

In general, qualified benefits are certain specified benefits that are excludable from an employee's gross income by reason of a specific provision of the Code. Thus, employer-provided accident or health coverage, group-term life insurance coverage (whether or not subject to tax by reason of being in excess of the dollar limit on the exclusion for such insurance), and benefits under dependent care assistance programs may be provided through a cafeteria plan. The cafeteria plan exception from the principle of constructive receipt generally also applies for employment tax (FICA and FUTA) purposes.[33]

Long-term care insurance cannot be provided under a cafeteria plan.

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[33] Elective contributions under a qualified cash or deferred arrangement that is part of a cafeteria plan are subject to employment taxes.

Flexible spending arrangements

A flexible spending arrangement ("FSA") is a reimbursement account or other arrangement under which an employer pays or reimburses employees for medical expenses or certain other nontaxable employer-provided benefits, such as dependent care. An FSA may be part of a cafeteria plan and may be funded through salary reduction. FSAs may also be provided by an employer outside a cafeteria plan. FSAs are commonly used, for example, to reimburse employees for medical expenses not covered by insurance. Qualified long-term care services cannot be provided through an FSA.

House Bill

Deduction for qualified long-term care insurance expenses

The provision provides an above-the-line deduction for a percentage of the amount paid during the year for long-term care insurance which constitutes medical care (as defined under sec. 213) for the taxpayer and his or her spouse and dependents.[34] The deductible percentage is: 25 percent in 2001, 2002, and 2003; 50 percent in 2004 and 2005; and 100 percent in 2006 and thereafter.

The deduction is not available to an individual for any month in which the individual is covered under an employer-sponsored health plan if at least 50 percent of the cost of the coverage is paid or incurred by the employer.[35] For purposes of this rule, any amounts excludable from the gross income of the employee with respect to qualified long-term care insurance are treated as paid or incurred by the employer. In determining whether the 50-percent threshold is met, all plans of the employer providing long-term care in which the employee participates are treated as a single plan. If the employer pays less than 50 percent of the cost of all long-term care plans in which the individual participates, the deduction is available only with respect to each plan with respect to which the employer pays for less than 50 percent of the cost. Cost is determined as under the health care continuation rules.

Long-term care insurance provided through a cafeteria plan

The provision authorizes the Secretary to prescribe rules necessary to carry out the provision, including appropriate reporting requirements for employers.

The provision provides that qualified long-term care insurance is a qualified benefit under a cafeteria plan. The provision also provides that qualified long-term care services can be provided under an FSA.[36]

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[34] The deduction would only apply to insurance that constitutes medical care; it would not apply to long-term care insurance expenses. The deduction would apply to self-insured arrangements (provided such arrangements constitute insurance, e.g., there is appropriate risk-shifting) and coverage under employer plans treated as insurance under section 104. Another provision of the bill provides a similar deduction for health insurance expenses.

[35] This rule is applied separately with respect to health insurance.

[36] Excludable employer contributions to a flexible spending arrangement or a cafeteria plan for qualified long-term care insurance or services are considered an amount paid by the employer for long-term care insurance.

Effective date

The provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

Deduction for qualified long-term care insurance expenses

The provision is the same as the House bill, with the following modification. Under the Senate amendment, the percentage deduction for qualified long-term care insurance expenses is as follows: 25 percent in 2001, 2002, and 2003; 50 percent in 2004 and 2005; and 100 percent in 2006 and thereafter.

Long-term care insurance provided through a cafeteria plan

The Senate amendment is the same as the House bill, with the modification that qualified long-term care insurance is treated as a qualified benefit under the cafeteria plan rules only to the extent that such insurance is treated as a medical expense under the itemized deduction for medical expenses (i.e., only to the extent of the premium limitations under sec. 213).

Effective date

The Senate amendment is the same as the House bill.

Conference Agreement

Deduction for qualified long-term care insurance expenses

The conference agreement follows the Senate amendment, with modifications to the deductible percentage.

As under the Senate amendment, the 50-percent rule is applied separately to health insurance and qualified long-term care insurance. For example, suppose an employee participates in a health insurance plan of the employer and that the employer pays for 100 percent of the cost of the coverage. The employee also participates in an employer-sponsored qualified long-term care insurance plan, and the employer pays for 10 percent of the cost of the qualified long-term care insurance. The employee pays for the remaining 90 percent of the long-term care insurance premium on an after-tax basis. The employee is not entitled to the deduction for health insurance expenses, but may deduct the 90 percent of the long-term care insurance premium she pays on an after-tax basis (subject to the premium limitations contained in section 213).

Long-term care insurance provided through a cafeteria plan

The conference agreement follows the Senate amendment. Under the conference agreement, as under the Senate amendment, the qualified long-term care insurance may only be offered under a cafeteria plan to the extent the cost of such insurance does not exceed the premium limitations contained in section 213.

Effective date

The provision is effective with respect to years beginning after December 31, 2001.

C. Extend Availability of Medical Savings Accounts (sec. 503 of the House bill and sec. 220 of the Code)

Present Law

In general

Within limits, contributions to a medical savings account ("MSA")[37] are deductible in determining AGI if made by an eligible individual and are excludable from gross income and wages for employment tax purposes if made by the employer of an eligible individual. Earnings on amounts in an MSA are not currently taxable. Distributions from an MSA for medical expenses are not taxable. Distributions not used for medical expenses are taxable. In addition, distributions not used for medical expenses are subject to an additional 15-percent tax unless the distribution is made after age 65, death, or disability.

Eligible individuals

MSAs are available to employees covered under an employer-sponsored high deductible plan of a small employer and self-employed individuals regardless of the size of the entity for which the individual performs services.[38] An employer is a small employer if it employed, on average, no more than 50 employees on business days during either the preceding or the second preceding year.

In order for an employee of a small employer to be eligible to make MSA contributions (or to have employer contributions made on his or her behalf), the employee must be covered under an employer-sponsored high deductible health plan (see the definition below) and must not be covered under any other health plan (other than a plan that provides certain permitted coverage, described below). In the case of an employee, contributions can be made to an MSA either by the individual or by the individual's employer. However, an individual is not eligible to make contributions to an MSA for a year if any employer contributions are made to an MSA on behalf of the individual for the year. Similarly, if the individual's spouse is covered under the high deductible plan covering such individual and the spouse's employer makes a contribution to an MSA for the spouse, the individual may not make MSA contributions for the year.

Similarly, in order to be eligible to make contributions to an MSA, a self-employed individual must be covered under a high deductible health plan and no other health plan (other than a plan that provides certain permitted coverage, described below). A self-employed individual is not an eligible individual (by reason of being self-employed) if the high deductible plan under which the individual is covered is established or maintained by an employer of the individual (or the individual's spouse).

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[37] In general, an MSA is a trust or custodial account created exclusively for the benefit of the account holder and is subject to rules similar to those applicable to individual retirement arrangements. The trustee of an MSA can be a bank, insurance company, or other person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with applicable requirements.

[38] Self-employed individuals include more than 2–percent shareholders of S corporations who are treated as partners for purposes of fringe benefit rules pursuant to section 1372.

An individual with other coverage in addition to a high deductible plan is still eligible for an MSA if such other coverage is certain permitted insurance or is coverage (whether provided through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care. Permitted insurance is: (1) Medicare supplemental insurance; (2) insurance if substantially all of the coverage provided under such insurance relates to (a) liabilities incurred under worker's compensation law, (b) tort liabilities, (c) liabilities relating to ownership or use of property (e.g., auto insurance), or (d) such other similar liabilities as the Secretary may prescribe by regulations; (3) insurance for a specified disease or illness; and (4) insurance that provides a fixed payment for hospitalization.

If a small employer with an MSA plan ceases to become a small employer (i.e., exceeds the 50-employee limit), then the employer (and its employees) can continue to establish and make contributions to MSAs (including contributions for new employees and employees that did not previously have an MSA) until the year following the first year in which the employer has more than 200 employees. After that, those employees who had an MSA (to which individual or employer contributions were made in any year) can continue to make contributions (or have contributions made on their behalf) even if the employer has more than 200 employees.

Tax treatment of and limits on contributions

Individual contributions to an MSA are deductible (within limits) in determining adjusted gross income (i.e., "above the line"). In addition, employer contributions are excludable from gross income and wages for employment tax purposes (within the same limits), except that this exclusion does not apply to contributions made through a cafeteria plan. No deduction is allowed to any individual for MSA contributions if such individual is a dependent on another taxpayer's tax return.

In the case of a self-employed individual, the deduction cannot exceed the individual's earned income from the trade or business with respect to which the high deductible plan is established. In the case of an employee, the deduction cannot exceed the individual's compensation attributable to the employer sponsoring the high deductible plan in which the individual is enrolled.

The maximum annual contribution that can be made to an MSA for a year is 65 percent of the deductible under the high deductible plan in the case of individual coverage and 75 percent of the deductible in the case of family coverage.

Contributions for a year can be made until the due date for the individual's tax return for the year (determined without regard to extensions).

If an employer provides high deductible health plan coverage coupled with an MSA to employees and makes employer contributions to the MSAs during a calendar year, the employer must make available a comparable contribution on behalf of all employees with comparable coverage during the same coverage period in the calendar year. Contributions are considered comparable if they are either of the same dollar amount or the same percentage of the deductible under the high deductible plan. The comparability rule

does not restrict contributions that can be made to an MSA by a self-employed individual.

If employer contributions do not comply with the comparability rule during a calendar year, then the employer is subject to an excise tax equal to 35 percent of the aggregate amount contributed by the employer to MSAs of the employer for the year. In the case of a failure to comply with the comparability rule which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed to the extent that the payment of the tax is excessive relative to the failure involved.

Definition of high deductible plan

A high deductible plan is a health plan with an annual deductible of at least $1,550 and no more than $2,300 in the case of individual coverage and at least $3,050 and no more than $4,600 in the case of family coverage. In addition, the maximum out-of-pocket expenses with respect to allowed costs (including the deductible) must be no more than $3,050 in the case of individual coverage and no more than $5,600 in the case of family coverage.[39] A plan does not fail to qualify as a high deductible plan merely because it does not have a deductible for preventive care as required by State law. A plan does not qualify as a high deductible health plan if substantially all of the coverage under the plan is for permitted coverage (as described above). In the case of a self-insured plan, the plan must in fact be insurance (e.g., there must be appropriate risk shifting) and not merely a reimbursement arrangement.

Tax treatment of MSAs

Earnings on amounts in an MSA are not currently includible in income.

Taxation of distributions

Distributions from an MSA for the medical expenses of the individual and his or her spouse or dependents generally are excludable from income.[40] However, in any year for which a contribution is made to an MSA, withdrawals from an MSA maintained by that individual generally are excludable from income only if the individual for whom the expenses were incurred was covered under a high deductible plan for the month in which the expenses were incurred.[41] This rule is designed to ensure that MSAs are in fact used in conjunction with a high deductible plan, and that they are not primarily used by other individuals who have health plans that are not high deductible plans.

For this purpose, medical expenses are defined as under the itemized deduction for medical expenses, except that medical expenses do not include expenses for insurance other than long-term care insurance, premiums for health care continuation coverage,

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[39] These dollar amounts are for 1999. These amounts are indexed for inflation in $50 increments.

[40] This exclusion does not apply to expenses that are reimbursed by insurance or otherwise.

[41] The exclusion still applies to expenses for continuation coverage or coverage while the individual is receiving unemployment compensation, even if for an individual who is not an eligible individual.

and premiums for health care coverage while an individual is receiving unemployment compensation under Federal or State law.

Distributions that are not used for medical expenses are includible in income. Such distributions are also subject to an additional 15-percent tax unless made after age 65, death, or disability.

Cap on taxpayers utilizing MSAs

The number of taxpayers benefiting annually from an MSA contribution is limited to a threshold level (generally 750,000 taxpayers). If it is determined in a year that the threshold level has been exceeded (called a "cut-off" year) then, in general, for succeeding years during the 4-year pilot period 1997–2000, only those individuals who (1) made an MSA contribution or had an employer MSA contribution for the year or a preceding year (i.e., are active MSA participants) or (2) are employed by a participating employer, is eligible for an MSA contribution. In determining whether the threshold for any year has been exceeded, MSAs of individuals who were not covered under a health insurance plan for the six month period ending on the date on which coverage under a high deductible plan commences would not be taken into account.[42] However, if the threshold level is exceeded in a year, previously uninsured individuals is subject to the same restriction on contributions in succeeding years as other individuals. That is, they would not be eligible for an MSA contribution for a year following a cut-off year unless they are an active MSA participant (i.e., had an MSA contribution for the year or a preceding year) or are employed by a participating employer.

The number of MSAs established has not exceeded the threshold level.

End of MSA pilot program

After December 31, 2000, no new contributions may be made to MSAs except by or on behalf of individuals who previously had MSA contributions and employees who are employed by a participating employer. An employer is a participating employer if (1) the employer made any MSA contributions for any year to an MSA on behalf of employees or (2) at least 20 percent of the employees covered under a high deductible plan made MSA contributions of at least $100 in the year 2000.

Self-employed individuals who made contributions to an MSA during the period 1997–2000 also may continue to make contributions after 2000.

House Bill

Eligible individuals and cap on MSAs

The House bill expands availability of MSAs to include all employees covered under a high deductible plan of an employer. Self-employed individuals continue to be eligible to contribute to an MSA.

The House bill also eliminates the cap on the number of taxpayers that can benefit annually from MSA contributions.

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[42] Permitted coverage, as described above, does not constitute coverage under a health insurance plan for this purpose.

Definition of high deductible plan and limits on contributions

The provision modifies the definition of a high deductible plan by decreasing the lower threshold for the annual deductible. Thus, under the provision, a high deductible plan means a plan with an annual deductible of at least $1,000 and not more than $2,300 (indexed) in the case of individual coverage and at least $2,000 and not more than $4,600 (indexed) in the case of family coverage. The limits on out-of-pocket expenses is the same as under present law.

The provision increases the amount of deductible (or excludable) contributions to an MSA to 100 percent of the deductible under the high deductible plan. The provision also allows an individual to make deductible contributions to an MSA even if the individual's employer also made contributions. The provision provides that MSAs may be offered as part of a cafeteria plan. The total contributions to MSAs on behalf on an individual for a year may not exceed 100 percent of the deductible under the high deductible plan.

End of MSA pilot program

The provision makes MSAs permanent.

Effective date

The provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

D. Additional Personal Exemption for Caretakers (sec. 504 of the House bill, sec. 503 of the Senate amendment and sec. 151 of the Code)

Present Law

Present law does not provide an additional personal exemption based solely on the custodial care of parents or grandparents. However, taxpayers with dependent parents generally are able to claim a personal exemption for each of these dependents, if they satisfy five tests: (1) a member of household or relationship test; (2) a citizenship test; (3) a joint return test; (4) a gross income test; and (5) a support test. The taxpayer is also required to list each dependent's tax identification number (the "TIN") on the tax return.

The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income ("AGI") in arriving at taxable income. The amount of each personal exemption is $2,750 for 1999, and is adjusted annually for inflation. For 1999, the total amount of the personal exemptions is phased out for taxpayers with AGI in excess of $126,600 for single taxpayers, $158,300 for heads of household, and $189,950 for married couples

filing joint returns. For 1999, the point at which a taxpayer's personal exemptions are completely phased out is $249,100 for single taxpayers, $280,800 for heads of households, and $312,450 for married couples filing joint returns.

House Bill

The House bill provides taxpayers who maintain a household including one or more "qualified persons" with an additional personal exemption for each qualified person.

A "qualified person" is an individual who: (1) satisfies a relationship test, (2) satisfies a residency test, (3) satisfies an identification test, and (4) has been certified as having long-term care needs. The individual satisfies the relationship test if the individual was the father or mother of: (a) the taxpayer, (b) the taxpayer's spouse, or (c) a former spouse of the taxpayer. A stepfather, stepmother, and ancestors of the father or mother are treated as a father or mother for these purposes.

An individual satisfies the residency test if the individual had the same principal place of abode as the taxpayer for the taxpayer's entire taxable year.

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

In order to be a qualified individual, an individual must be certified before the due date of the return for the taxable year (without extensions) by a licensed physician as having long-term care needs for period which is at least 180 consecutive days and a portion of which occurs within the taxable year. The certification must be made no more than 39½ months before the due date for the return (or within such other period as the Secretary has prescribed).

Under the provision, an individual has long-term care needs if the individual is unable to perform at least 2 activities of daily living ("ADLs") without substantial assistance from another individual, due to a loss of functional capacity. As with the present-law rules relating to long- term care, ADLs are: (1) eating; (2) toileting; (3) transferring; (4) bathing; (5) dressing; and (6) continence. Substantial assistance includes hands-on assistance (that is, the physical assistance of another person without which the individual is unable to perform the ADL) and stand-by assistance (that is, the presence of another person within arm's reach of the individual that is necessary to prevent, by physical intervention, injury to the individual when performing the ADL).

As an alternative to the 2–ADL test described above, an individual is considered to have long-term care needs if he or she (1) requires substantial supervision for at least 6 months to be protected from threats to health and safety due to severe cognitive impairment and (2) is unable for at least 6 months to perform at least one or more ADLs or to engage in age appropriate activities as determined under regulations prescribed by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services.

The House bill provides that a taxpayer is treated as maintaining a household for any period only if over one-half of the cost of maintaining the household for such period is furnished by such tax-

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

Effective date.—The House bill provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

E. Expand Human Clinical Trials Expenses Qualifying for the Orphan Drug Tax Credit (sec. 505 of the House bill and sec. 45C of the Code)

Present Law

Taxpayers may claim a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions, generally those that afflict less than 200,000 persons in the United States. Qualifying expenses are those paid or incurred by the taxpayer after the date on which the drug is designated as a potential treatment for a rare disease or disorder by the Food and Drug Administration ("FDA") in accordance with the section 526 of the Federal Food, Drug, and Cosmetic Act.

House Bill

The House bill expands qualifying expenses to include those expenses related to human clinical testing incurred after the date on which the taxpayer files an application with the FDA for designation of the drug under section 526 of the Federal Food, Drug, and Cosmetic Act as a potential treatment for a rare disease or disorder. As under present law, the credit may only be claimed for such expenses related to drugs designated as a potential treatment for a rare disease or disorder by the FDA in accordance with section 526 of such Act.

Effective date.—The provision would be effective for expenditures paid or incurred after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

Effective date.—The provision would be effective for expenditures paid or incurred after December 31, 1999.

F. Add Certain Vaccines Against Streptococcus Pneumoniae to the List of Taxable Vaccines; Reduce Vaccine Excise Tax (sec. 506 of the House bill, sec. 504 of the Senate amendment and secs. 4131 and 4132 of the Code)

Present Law

A manufacturer's excise tax is imposed at the rate of 75 cents per dose (sec. 4131) on the following vaccines recommended for routine administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, HIB (haemophilus influenza type B), hepatitis B, varicella (chicken pox), and rotavirus gastroenteritis. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine.

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. This program provides a substitute Federal, "no fault" insurance system for the State-law tort and private liability insurance systems otherwise applicable to vaccine manufacturers and physicians. All persons immunized after September 30, 1988, with covered vaccines must pursue compensation under this Federal program before bringing civil tort actions under State law.

House Bill

The House bill adds any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines.

In addition, the House bill directs the General Accounting Office ("GAO") to report to the House Committee on Ways and Means and the Senate Committee on Finance on the operation and management of expenditures from the Vaccine Trust Fund and to advise the Committees on the adequacy of the Vaccine Trust Fund to meet future claims under the Federal Vaccine Injury Compensation Program.

The GAO is directed to report its findings to the House Committee on Ways and Means and the Senate Committee on Finance not later than December 31, 1999.

Effective date.—The provision is effective for vaccine purchases beginning on the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children.

Senate Amendment

The Senate amendment is identical to the House bill in adding any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines.

The Senate amendment also reduces the rate of tax applicable to all taxable vaccines from 75 cents per dose to 25 cents per dose for sales of vaccines after December 31, 2004.

The Senate amendment also changes the effective date enacted in Public Law 105–277 and certain other conforming amendments to expenditure purposes to enable certain payments to be made from the Trust Fund.

In addition, the Senate amendment is identical to the House bill in directing the General Accounting Office ("GAO") to report to the House Committee on Ways and Means and the Senate Committee on Finance on the operation and management of expenditures from the Vaccine Trust Fund and to advise the Committees on the adequacy of the Vaccine Trust Fund to meet future claims under the Federal Vaccine Injury Compensation Program, except that the GAO is directed to report its findings to the House Committee on Ways and Means and the Senate Committee on Finance within one year of the date of enactment.

Effective date.—The provision is effective for vaccine purchases beginning on the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children. The addition of conjugate streptococcus pneumoniae vaccines to the list of taxable vaccines is contingent upon the inclusion in this legislation of the modifications to Public Law 105–277.

The provision to reduce the rate of tax to 25 cents per dose would be effective for sales after December 31, 2004. No floor stocks refunds would be permitted for vaccines held on December 31, 2004. For the purpose of determining the amount of refund of tax on a vaccine returned to the manufacturer or importer, for vaccines returned after August 31, 2004 and before January 1, 2005, the amount of tax assumed to have been paid on the initial purchase of the returned vaccine is not to exceed $0.25 per dose. The reduction in the rate of tax is contingent upon the inclusion in this legislation of the modifications to Public Law 105–277.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment in adding any conjugate vaccine against streptococcus pneumoniae to the list of taxable vaccines. In addition, the conference agreement follows the House bill and the Senate amendment by changing the effective date enacted in Public Law 105–277 and certain other conforming amendments to expenditure purposes to enable certain payments to be made from the Trust Fund.

The conference agreement also reduces the rate of tax applicable to all taxable vaccines from 75 cents per dose to 50 cents per dose for sales of vaccines after December 31, 2004.

In addition, the conferees direct the General Accounting Office ("GAO") to report to the House Committee on Ways and Means and the Senate Committee on Finance on the operation and manage-

ment of expenditures from the Vaccine Trust Fund and to advise the Committees on the adequacy of the Vaccine Trust Fund to meet future claims under the Federal Vaccine Injury Compensation Program.

Within its report, to the greatest extent possible, the conferees would like to see a thorough statistical report of the number of claims submitted annually, the number of claims settled annually, and the value of settlements. The conferees would like to learn about the statistical distribution of settlements, including the mean and median values of settlements, and the extent to which the value of settlements varies with an injury attributed to an identifiable vaccine. The conferees also would like to learn about the settlement process, including a statistical distribution of the amount of time required from the initial filing of a claim to a final resolution.

The Code provides that certain administrative expenses may be charged to the Vaccine Trust Fund. The conferees intend that the GAO report include an analysis of the overhead and administrative expenses charged to the Vaccine Trust Fund.

The conferees request that the GAO report its findings to the House Committee on Ways and Means and the Senate Committee on Finance not later than December 31, 1999.

Effective date.—The provision is effective for vaccine purchases beginning on the day after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugated streptococcus pneumonia vaccines to children. No floor stocks tax is to be collected for amounts held for sale on that date. For sales on or before the date on which the Centers for Disease Control make final recommendation for routine administration of conjugate streptococcus pneumonia vaccines to children for which delivery is made after such date, the delivery date is deemed to be the sale date. The addition of conjugate streptococcus pneumoniae vaccines to the list of taxable vaccines is contingent upon the inclusion in this legislation of the modifications to Public Law 105–277.

The provision to reduce the rate of tax to 50 cents per dose would be effective for sales after December 31, 2004. No floor stocks refunds would be permitted for vaccines held on December 31, 2004. For the purpose of determining the amount of refund of tax on a vaccine returned to the manufacturer or importer, for vaccines returned after August 31, 2004 and before January 1, 2005, the amount of tax assumed to have been paid on the initial purchase of the returned vaccine is not to exceed $0.50 per dose.

G. Above-the-Line Deduction for Prescription Drug Insurance Coverage of Medicare Beneficiaries if Certain Medicare and Low-Income Assistance Provisions Are in Effect (sec. 507 of the House bill and sec. 213 of the Code)

Present Law

Individuals who itemize deductions may deduct their health insurance expenses, including the cost of prescription drugs, to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213).

House Bill

The provision provides an above-the-line deduction for Medicare beneficiaries for prescription drug insurance. The deduction will take effect when (a) the Federal Government provides assistance for prescription drug coverage for low-income Medicare beneficiaries, (b) all policies supplemental to Medicare provide coverage for costs of prescription drugs, and (c) coverage for outpatient prescription drugs for Medicare beneficiaries is provided only through integrated comprehensive health plans which offer current Medicare covered services and maximum limitations on out-of-pocket spending and such comprehensive plans sponsored by the Health Care Financing Administration compete on the same basis as private plans.

Effective date.—The provision is effective for taxable years beginning after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill with modifications. The conference agreement modifies the contingency with respect to Medicare supplemental policies requiring all such policies to provide prescription drug coverage to require that at least one of the benefit packages authorized to be offered under a Medicare supplemental policy is a package which provides solely for the coverage of costs for prescription drugs. The conference agreement also includes an additional contingency in order for the above-the-line deduction contained in the House bill to take effect. Under the conference agreement, the above-the-line deduction is also contingent upon the enactment of a provision, included in the conference agreement effective for taxable years beginning after December 31, 2002, that provides that, in the case of individuals enrolled in Medicare, medical expenses for purposes of the itemized deduction for medical care includes formerly prescription drugs. Formerly prescription drugs are drugs that within the year of purchase or the two preceding taxable years were available by prescription only.

H. Credit for Employee Health Insurance Expenses of Small Employers (sec. 609 of the Senate amendment and new sec. 45E of the Code)

Present Law

Under present law, employee health insurance expenses paid by the employer are generally deductible as an ordinary and necessary business expense.

House Bill

No provision.

Senate Amendment

The Senate amendment allows small employers a credit for the amount paid by the employer during the taxable year with respect to health insurance expenses of qualified employees.[43] The credit is equal to 60 percent of such expenses in the case of self-only coverage of a qualified employee and 70 percent in the case of family coverage. The maximum amount that can be taken into account in determining the credit with respect to any qualified employee for a taxable year may not exceed $1,000 in the case of self-only coverage and $1,715 in the case of family coverage. No deduction is allowed with respect to expenses taken into account under the credit.

An employer is a small employer for a year if the employer employed an average of 9 or fewer employees on business days during either of the 2 preceding calendar years. A special rule applies in the case of employers that were not in business in the preceding calendar year.

A qualified employee is an employee of the employer receiving total wages at an annual rate of more than $5,000 and not more than $16,000. Beginning after 2001, the $16,000 limit is indexed for cost-of-living adjustments. An employee does not include self-employed individuals. Leased employees (with in the meaning of sec. 414(n) are treated as employees for purposes of the credit.

The credit is part of the general business credit.

Effective date.—The provision is effective for amounts paid or incurred in taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment.

VI. ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX RELIEF PROVISIONS

A. Phase in Repeal of Estate, Gift, and Generation-Skipping Taxes (secs. 601–603, 611, and 621 of the House bill, secs. 701–702 of the Senate amendment, and secs. 2001–2704 of the Code)

Present Law

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. The gift tax and the estate tax are unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death. The unified estate and gift tax rates begin at 18 percent on the first $10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million. In addition, a 5-percent surtax is imposed on taxable transfers at death between $10 million and the amount necessary to phase out the benefits of the graduated rates.

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[43] Salary reduction contributions are not treated as employer payments for purposes of the credit.

A unified credit is available with respect to taxable transfers by gift and at death. The unified credit amount effectively exempts from tax a total of $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.

A generation-skipping transfer ("GST") tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations, and taxable distributions. The GST tax is imposed at the top estate and gift tax rate (which, under present law, is 55 percent) on cumulative generation-skipping transfers in excess of $1 million (indexed beginning in 1999).

The basis of property acquired or passing from a decedent generally is its fair market value on the date of the decedent's death (or, if the alternative valuation date is elected, the earlier of six months after death or the date the property is sold or distributed by the estate). This step up (or step down) in basis eliminates the recognition of any income on the appreciation of the property that occurred prior to the decedent's death, and it has the effect of eliminating any tax benefit from any unrealized loss. The basis of property acquired by gift generally is the same as it was in the hands of the donor. However, if the donor's basis was greater than the fair market value of the property at the time of gift, then, for purposes of determining loss on the disposition of the property, the basis is its fair market value at the time of gift.

House Bill

The House bill repeals the 5-percent surtax (which phases out the benefit of the graduated rates), the unified credit is converted into a unified exemption, and the rates in excess of 53 percent are repealed beginning in 2001. In 2002, the rates in excess of 50 percent are repealed.

In 2003 through 2006, all estate and gift tax rates are reduced by 1 percentage point per year. In 2007, all estate and gift tax rates are reduced by 1.5 percentage points. In 2008, all estate and gift tax rates are reduced by 2 percentage points.

Beginning in 2009, the estate, gift, and GST taxes are repealed, and carryover basis applies for transfers from estates in excess of $2 million (the carryover basis regime is phased in for transfers from estates valued in excess of $1.3 million and not over $2 million). Transfers to surviving spouses will continue to receive a step up in basis.

Effective date.—The unified credit is replaced with a unified exemption, and the 5-percent surtax and rates in excess of 53 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2000. The rates in excess of 50 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2001.

All estate and gift tax rates are reduced by 1 percentage point for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2002, but before January 1,

2007. All estate and gift tax rates are reduced by 1.5 percentage points for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2006, but before January 1, 2008. All estate and gift tax rates are reduced by 2 percentage points for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2008.

The estate, gift, and GST taxes are repealed and the carryover basis regime takes effect for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2008.

Senate Amendment

The Senate amendment repeals the rates in excess of 53 percent beginning in 2001. Beginning in 2004, the 5-percent bubble (which phases out the benefits of the graduated rates) is repealed and the unified credit is converted into a unified exemption. Beginning in 2007, the unified exemption is increased from $1 million to $1.5 million.

Effective date.—The rates in excess of 53 percent are repealed and the unified credit is converted into a unified exemption, both for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2003. The unified exemption is increased from $1 million to $1.5 million for estates of decedents dying and gifts made after December 31, 2006.

Conference Agreement

The conference agreement follows the House bill, with modifications. After the estate, gift, and GST taxes are repealed and the carryover basis regime takes effect, the first $3 million of transfers from decedents to surviving spouses will receive a step up in basis. Transfers to surviving spouses that are eligible for a step up in basis are not counted toward the transfers for which the carryover basis regime is phased in for estates valued in excess of $1.3 million and not over $2 million.

Effective date.—Same as the House bill.

B. Modify Generation-Skipping Transfer Tax Rules

1. Deemed allocation of the generation-skipping transfer ("GST") tax exemption to lifetime transfers to trusts that are not direct skips (sec. 631 of the House bill and sec. 2632 of the Code)

Present Law

A GST tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (e.g., grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip).

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate in effect at the time of the transfer (55 percent under present law) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred in a GST indicates the amount of GST tax exemption allocated to a trust. The allocation of GST tax exemption reduces the 55-percent tax rate on a GST.

If an individual makes a direct skip during his or her lifetime, any unusued GST tax exemption is automatically allocated to the direct skip to the extent necessary to make the inclusion ratio for such property as low as possible. An individual may elect out of the automatic allocation for lifetime direct skips.

For lifetime transfers made to a trust that are not direct skips, the transferor must allocate GST tax exemption—the allocation is not automatic. If GST tax exemption is allocated on a timely-filed gift tax return, then the portion of the trust which is exempt from GST tax is based on the value of the property at the time of the transfer. If, however, the allocation is not made on a timely-filed gift tax return, then the portion of the trust which is exempt from GST tax is based on the value of the property at the time the allocation of GST tax exemption was made.

Treas. Reg. 26.2632–1(d) further provides that any unused GST tax exemption, which has not been allocated to transfers made during an individual's life, is automatically allocated on the due date for filing the decedent's estate tax return. Unused GST tax exemption is allocated pro rata on the basis of the value of the property as finally determined for estate tax purposes, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused GST tax exemption is allocated pro rata on the basis of the estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

House Bill

Under the House bill, GST tax exemption is automatically allocated to transfers made during life that are "indirect skips." An indirect skip is any transfer of property (that is not a direct skip) subject to the gift tax that is made to a GST trust.

A GST trust is defined as a trust that could have a GST with respect to the transferor (e.g., a taxable termination or taxable distribution), unless:

> the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons (a) before the date that the individual attains age 46, or (b) on or before 1 or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or (c) upon the occurrence of an event that, in accordance with regulations prescribed by the Treasury Secretary, may reasonably be expected to occur before the date that such individual attains age 46;
>
> the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by 1 or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;
>
> the trust instrument provides that, if 1 or more individuals who are non-skip persons die on or before a date or event described in clause (1) or (2), more than 25 percent of the trust corpus either must be distributed to the estate or estates of 1 or more of such individuals or is subject to a general power of appointment exercisable by 1 or more of such individuals;
>
> the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;
>
> the trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable unitrust; or
>
> the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

If any individual makes an indirect skip during the individual's lifetime, then any unused portion of such individual's GST tax exemption is allocated to the property transferred to the extent necessary to produce the lowest possible inclusion ratio for such property.

An individual may elect not to have the automatic allocation rules apply to an indirect skip, and such elections will be deemed timely if filed on a timely-filed gift tax return for the calendar year in which the transfer was made or deemed to have bee made or on such later date or dates as may be prescribed by the Treasury Secretary. An individual may elect not to have the automatic alloca-

tion rules apply to any or all transfers made by such individual to a particular trust and may elect to treat any trust as a GST trust with respect to any or all transfers made by the individual to such trust, and such election may be made on a timely-filed gift tax return for the calendar year for which the election is to become effective.

Effective date.—The provision applies to transfers subject to estate or gift tax made after December 31, 1999, and to estate tax inclusion periods ending after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Retroactive allocation of the GST tax exemption (sec. 631 of the House bill, sec. 731 of the Senate amendment, and sec. 2632 of the Code)

Present Law

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates GST tax exemption to a trust prior to the taxable termination or taxable distribution, GST tax may be avoided.

A transferor likely will not allocate GST tax exemption to a trust that the transferor expects will benefit only non-skip persons. However, if a taxable termination occurs because, for example, the transferor's child unexpectedly dies such that the trust terminates in favor of the transferor's grandchild, and GST tax exemption had not been allocated to the trust, then GST tax would be due even if the transferor had unused GST tax exemption.

House Bill

Under the House bill, GST tax exemption may be allocated retroactively when there is an unnatural order of death. If a lineal descendant of the transferor predeceased the transferor, then the transferor may allocate any unused GST tax exemption to any previous transfer or transfers to the trust on a chronological basis. The provision allows a transferor to retroactively allocate GST tax exemption to a trust where a beneficiary (a) is a non-skip person, (b) is a lineal descendant of the transferor's grandparent or grandparent of the transferor's spouse, (c) is a generation younger than the generation of the transferor, and (d) dies before the transferor. Exemption is allocated under this rule retroactively, and the applicable fraction and inclusion ratio under this provision are deter-

mined based on the value of the property on the date that the property was transferred to the trust.

Effective date.—The provision applies to deaths of non-skip persons occurring after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 632 of the House bill, sec. 732 of the Senate amendment, and sec. 2642 of the Code)

Present Law

An exemption of $1 million (indexed beginning in 1999) is provided for each person making generation-skipping transfers. The exemption may be allocated by a transferor (or his or her executor) to transferred property.

If the value of transferred property exceeds the amount of the GST tax exemption allocated to that property, then the GST tax generally is determined by multiplying a flat tax rate equal to the highest estate tax rate (55 percent under present law) by the "inclusion ratio" and the value of the taxable property at the time of the taxable event. The "inclusion ratio" is the number one minus the "applicable fraction." The applicable fraction is a fraction calculated by dividing the amount of the GST tax exemption allocated to the property by the value of the property.

Under Treas. Reg. 26.2654–1(b), a trust may be severed into two or more trusts (e.g., one with an inclusion ratio of zero and one with an inclusion ratio of one) only if (1) the trust is severed according to a direction in the governing instrument or (2) the trust is severed pursuant to the trustee's discretionary powers, but only if certain other conditions are satisfied (e.g., the severance occurs or a reformation proceeding begins before the estate tax return is due). Under current Treasury regulations, however, a trustee cannot establish inclusion ratios of zero and one by severing a trust that is subject to the GST tax after the trust has been created.

House Bill

Under the House bill, a trust may be severed in a "qualified severance." A qualified severance is defined as the division of a single trust and the creation of two or more trusts if (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an inclusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case,

the trust receiving such fractional share shall have an inclusion ratio of one. Under the provision, a trustee may elect to sever a trust in a qualified severance at any time.

Effective date.—The provision is effective for severances of trusts occurring after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Modification of certain valuation rules (sec. 633 of the House bill, sec. 733 of the Senate amendment, and sec. 2642 of the Code)

Present Law

Under present law, the inclusion ratio is determined using gift tax values for allocations of GST tax exemption made on timely filed gift tax returns. The inclusion ratio generally is determined using estate tax values for allocations of GST tax exemption made to transfers at death. Treas. Reg. 26.2642–5(b) provides that, with respect to taxable terminations and taxable distributions, the inclusion ratio becomes final on the later of the period of assessment with respect to the first transfer using the inclusion ratio or the period for assessing the estate tax with respect to the transferor's estate.

House Bill

Under the House bill, in connection with timely and automatic allocations of GST tax exemption, the value of the property for purposes of determining the inclusion ratio shall be its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. In the case of a GST tax exemption allocation deemed to be made at the conclusion of an estate tax inclusion period, the value for purposes of determining the inclusion ratio shall be its value at that time.

Effective date.—The provision is effective as though included in the amendments made by section 1431 of the Tax Reform Act of 1986.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Relief from late elections (sec. 634 of the House bill, sec. 734 of the Senate amendment, and sec. 2642 of the Code)

Present Law

An election to allocate GST tax exemption to a specific transfer may be made at any time up to the time for filing the transferor's estate tax return. If an allocation is made on a gift tax return filed timely with respect to the transfer to a trust, then the value on the date of transfer to the trust is used for determining GST tax exemption allocation. However, if the allocation relating to a specific transfer is not made on a timely-filed gift tax return, then the value on the date of allocation must be used. There is no statutory provision allowing relief for an inadvertent failure to make an election on a timely-filed gift tax return to allocate GST tax exemption.

House Bill

Under the House bill, the Treasury Secretary is authorized and directed to grant extensions of time to make the election to allocate GST tax exemption and to grant exceptions to the time requirement. If such relief is granted, then the value on the date of transfer to a trust would be used for determining GST tax exemption allocation.

In determining whether to grant relief for late elections, the Treasury Secretary is directed to consider all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems relevant. For purposes of determining whether to grant relief, the time for making the allocation (or election) is treated as if not expressly prescribed by statute.

Effective date.—The provision applies to requests pending on, or filed after, the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. The conferees expect that the Treasury Secretary will issue regulations that will facilitate the liberal granting of relief under this provision.

6. Substantial compliance (sec. 634 of the House bill, sec. 734 of the Senate amendment, and sec. 2642 of the Code)

Present Law

Under present law, there is no statutory rule which provides that substantial compliance with the statutory and regulatory requirements for allocating GST tax exemption will suffice to establish that GST tax exemption was allocated to a particular transfer or trust.

House Bill

Under the House bill, substantial compliance with the statutory and regulatory requirements for allocating GST tax exemption will suffice to establish that GST tax exemption was allocated to a particular transfer or a particular trust. If a taxpayer demonstrates substantial compliance, then so much of the transferor's unused GST tax exemption will be allocated to the extent it produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances will be considered, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems appropriate.

Effective date.—The substantial compliance provisions are effective on the date of enactment and apply to allocations made prior to such date for purposes of determining the tax consequences of generation-skipping transfers with respect to which the period of time for filing claims for refund has not expired.[44]

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Expand Estate Tax Rule for Conservation Easements (sec. 711 of the Senate amendment and sec. 2031 of the Code)

Present Law

An executor may elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement, up to a maximum exclusion of $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter (sec. 2031(c)). The exclusion percentage is reduced by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right).

A qualified conservation easement is one that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of sec. 170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent

[44] No implication is intended with respect to the application of a rule of substantial compliance prior to enactment of this provision.

or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose.

In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent's family, the executor of the decedent's estate, or the trustee of a trust holding the land, no later than the date of the election. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Property financed with acquisition indebtedness is eligible for this provision only to the extent of the net equity in the property. The exclusion from estate taxes does not extent to the value of any development rights retained by the decedent or donor.

House Bill

No provision.

Senate Amendment

The Senate amendment expands the availability of qualified conservation easements by modifying the distance requirements. Under the provision, the distance from which the land must be situated from a metropolitan area, national park, or wilderness area is increased from 25 to 50 miles, and the distance from which the land must be situated from an Urban National Forest is increased from 10 to 25 miles. The Senate amendment also clarifies that the date for determining easement compliance is the date on which the donation was made.

Effective date.—The provision that clarifies the date for determining easement compliance is effective for estates of decedents dying after December 31, 1997. The provisions that modify the distance rules are effective for estates of decedents dying after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

D. Increase Annual Gift Exclusion (sec. 721 of the Senate amendment)

Present Law

An annual exclusion of $10,000 of transfers of present interests in property is provided for each donee. If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $20,000 for each donee. Unlimited transfers between spouses are permitted without imposition of a gift tax. In the case of gifts made after 1998, the $10,000 amount is increased by a cost-of-living adjustment.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the annual gift exclusion for each donee is increased to $20,000 beginning in 2005.

Effective date.—The annual gift exclusion is increased to $20,000, for each donee, for gifts made after December 31, 2004.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

E. Increase Estate Tax Deduction for Family-Owned Business Interest (sec. 608 of the Senate amendment and sec. 2057 of the Code)

Present Law

An estate is permitted to deduct the adjusted value of the qualified "family-owned business interests" of the decedent, up to a total of $675,000. The deduction plus the unified credit exclusion amount may not exceed $1.3 million. If the deduction is taken, then the unified credit exclusion amount is $625,000; however, if the deduction is less than $675,000, then the unified credit is increased (but not above the unified credit that would apply without regard to the deduction) by the excess of $675,000 over the deduction allowed. (Code sec. 2057.)

A qualified family-owned business interest is defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if one family owns at least 50 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent's family owns at least 30 percent of the trade or business. An interest in a trade or business does not qualify if any interest in the business (or a related entity) was publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also does not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in sec. 543). In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules apply. The value of a trade or business qualifying as a family-owned business interest is reduced to the extent the business holds passive assets or excess cash or marketable securities.

To qualify for the deduction, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least 5 of the 8 years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) is required to actively participate in the trade or business for at least 10 years following the decedent's death.

The benefit of the deduction for qualified family-owned business interests is subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to

meet the material participation requirements; (2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution; (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship.

The portion of the reduction in estate taxes that is recaptured depends upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business between the date of the decedent's death and the date of the recapture event. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest is recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes is recaptured; if the participation was for at least seven years but less than eight years, 60 percent is recaptured; if the participation was for at least eight years but less than nine years, 40 percent is recaptured; and if the participation was for at least nine years but less than ten years, 20 percent of the reduction in estates taxes is recaptured. In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under section 2032A(c)(7)(A), however, the 10-year recapture period may be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

House Bill

No provision.

Senate Amendment

The Senate amendment increases the qualified "family-owned business interests" deduction from $675,000 to $1.975 million. The deduction plus the unified credit exclusion amount may not exceed $2.6 million.

Effective date.—The provision is effective for decedents dying after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

VII. DISTRESSED COMMUNITIES AND INDUSTRIES PROVISIONS

A. Renewal Community Provisions (secs. 701–706 of the House bill and secs. 51, 198, 4973, 4975, 6047, 6104, 6693, and new secs. 1400E–L of the Code)

Present Law

Pursuant to the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993"), the Secretaries 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. Of the nine empowerment zones, six are in urban areas and three are in rural areas.[45]

In general, businesses located in these empowerment zones qualify for the following tax incentives: (1) a 20-percent wage credit for the first $15,000 of wages paid to a zone resident who works in the empowerment zone; (2) an additional $20,000 of section 179 expensing for certain property placed in service by an enterprise zone business; and (3) special tax-exempt financing for certain zone facilities. Businesses located in enterprise communities are eligible for the special tax-exempt financing benefits but not the other tax incentives available in the empowerment zones. The tax incentives for empowerment zones and enterprise communities generally remain in effect for ten years.

The Taxpayer Relief Act of 1997 ("1997 Act") authorized the designation of two new urban empowerment zones[46] and 20 additional empowerment zones. The new urban empowerment zones, whose designations take effect on January 1, 2000, are eligible for substantially the same tax incentives as the nine empowerment zones authorized by OBRA 1993 except that the wage credit is phased down beginning in 2005 and expires after 2007. Businesses in the 20 additional empowerment zones are not eligible for the wage credit (but are eligible to receive up to $20,000 of additional section 179 expensing and to utilize the special tax-exempt financing benefits).

House Bill

The House bill authorizes the designation of 20 "renewal communities" within which special tax incentives would be available. The following is a description of the designation process and the tax incentives that would be available within the renewal communities.

Designation process

Designation of 20 renewal communities.—The House bill authorizes the Secretary of HUD to designate up to 20 "renewal communities" from areas nominated by States and local governments.

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[45] The six urban empowerment zones are located in New York City, Chicago, Atlanta, Detroit, Baltimore, and Philadelphia-Camden (New Jersey). The three rural empowerment zones are located in the Kentucky Highlands (Clinton, Jackson and Wayne counties, Kentucky), Mid-Delta Mississippi (Bolivar, Holmes, Humphreys, Leflore counties, Mississippi), and Rio Grande Valley Texas (Cameron, Hidalgo, Starr, and Willacy counties, Texas).

[46] The new urban empowerment zones are located in Los Angeles and Cleveland.

At least four of the designated communities must be in rural areas (defined as areas which are (1) within local government jurisdictions with a population less than 50,000, (2) outside of a metropolitan statistical area, or (3) determined by HUD to be a rural area). The Secretary of HUD would be required to publish (within four months after enactment) regulations describing the selection process; all designations of renewal communities would have to be made within 24 months after such regulations are published. The designation of an area as a renewal community terminates after December 31, 2007.[47]

Old empowerment zones and enterprise communities could seek additional designation as renewal communities.—The bill allows the previously designated empowerment zones and enterprise communities to apply for designation as renewal communities. Priority is given in the designation of the first ten renewal communities to nominated areas that are designated as empowerment zones or enterprise communities under present law and that otherwise meet the requirements 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 an empowerment zone or enterprise community remains 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 would be available.

Eligibility criteria.—To be designated as a renewal community, a nominated area must meet all of the following criteria: (1) each census tract has a poverty rate of at least 20 percent; (2) in the case of an urban area, 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 ten renewal communities when priority would be given to existing empowerment zones and enterprise communities (as described above), those areas with the highest average ranking of eligibility factors (1), (2), and (3) above would be designated as renewal communities. The Secretary of HUD shall 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 Government 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 provision merely requires that the boundary of a designated community be "continuous" and that the designated community have a minimum population of 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).

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[47] The designation would terminate earlier than December 31, 2007, if (1) an earlier termination date is designated by the State or local government in their designation, or (2) the Secretary of HUD revokes the designation as of an earlier date.

Required State and local government course of action.—In order for an area to be designated as a renewal community, State and local governments are required to submit a written course of action that 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 that 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 necessary for and well-tailored to the protection of health and safety.

Tax incentives for renewal communities

The following tax incentives generally would be available during the seven-year period beginning January 1, 2001, and ending December 31, 2007.

100-percent capital gain exclusion.—The bill provides for a 100 percent capital gains exclusion for capital gain from the sale of any qualified community asset acquired after December 31, 2000, and before January 1, 2008, and held for more than five years. A "qualified community asset" includes: (1) qualified community stock (meaning original-issue stock purchased for cash in a "renewal community business"); (2) a 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, 2000). A "renewal community business" is similar to the present-law definition of an enterprise zone business[48] except that 80 percent of the gross income must

[48] An "enterprise zone business" is defined as a corporation or partnership (or proprietorship) if for the taxable year: (1) the sole trade or business of the corporation or partnership is the active conduct of a qualified business within an empowerment zone or enterprise community; (2) at least 50 percent 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 attrib-

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be derived from the conduct of a qualified business within a renewal community. 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. The termination of an area's status as a renewal community does not affect whether property is a qualified community asset. Gain attributable to the period before January 1, 2001, and after December 31, 2007, is not eligible for the 100-percent exclusion.

Family development accounts.—The bill allow individuals 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 was allowed to claim the earned income credit (EIC) during the preceding taxable year. A qualified individual may claim a deduction of up to $2,000 per year for amounts he or she contributes to his or her own FDA. Any other person may contribute amounts to one or more FDAs established for the benefit of a qualified individual and deduct up to $1,000 per qualified individual. Contributions to an FDA made on or before April 15th of the current taxable year could be treated as made during the preceding taxable year. The bill permits (but does not require) individuals to direct that the IRS directly deposit their EIC refunds into an FDA on behalf of such individual.

The bill provides that up to five 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 two 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 Treasury Secretary must provide notice to residents of FDA matching demonstration areas of the availability of matching contributions.

An FDA is exempt from taxation (other than UBIT imposed by present-law section 511). A distribution from an FDA is not included in the gross income of the distributee if it is a "qualified family development distribution." A qualified family development distribution is defined as a distribution from an FDA that is used exclusively to pay for (1) qualified higher educational expenses, (2)

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utable 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 (sec. 1397B).

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. In addition, the leasing of real property that is located within the empowerment zone or community to others is treated as a qualified business only if (1) the leased property is not residential property, and (2) at least 50 percent of the gross rental income from the real property is from enterprise zone businesses. The rental of tangible personal property to others is not a qualified business unless 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 (sec. 1397B(d)).

qualified first-time homebuyer expenses, (3) qualified business capitalization costs[49], 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 additional tax (in the case of a distribution attributable to a demonstration matching contribution) or a 10-percent additional tax (in the case of any other distribution). The 100-percent and 10-percent additional 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 (thus subject to a 100-percent additional tax) until all such demonstration matching contributions have been withdrawn. This 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 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 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 deduction.—The bill allows each State to allocate an amount of "commercial revitalization deductions" with respect to qualified revitalization expenditures incurred in connection with a qualified revitalization building. The commercial revitalization deduction is equal to (a) 50 percent of qualified revitalization expenditures for the taxable year in which a qualified revitalization building is placed in service or, at the election of the taxpayer, (b) a 10-percent deduction for qualified revitalization expenditures per year for a 10-year period beginning with the year in which the building is placed in service. A "qualified revitalization expenditure" means the cost (up to $10 million) of constructing or substantially rehabilitating a building used for commercial purposes in a designated renewal community, including certain land acquisition costs. A commercial revitalization deduction would be in lieu of any depreciation deduction otherwise allowable on account of such expenditure.

Each State would be allowed to allocate no more than $6 million worth of commercial revitalization deductions to each renewal community located within the State for each calendar year after 2000 and before 2008. The appropriate State agency would make the allocations pursuant to a qualified allocation plan. The qualified allocation plan would (1) set forth the selection criteria to be used to determine priorities as appropriate to local conditions; (2) consider how the building project would contribute to the renewal community and its residents, and (3) provide a procedure that the agency would follow to monitor compliance.

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[49] As is the case for enterprise zone businesses, a qualified business capitalization cost would not include expenditures incurred for the capitalization of any trade or business described in section 144(c)(6)(B) (*e.g.,* a country club, hot tub facility, or liquor store).

A qualified revitalization building must be located in a renewal community and placed in service after December 31, 2000, and before January 1, 2008.

Additional section 179 expensing.—A renewal community business is allowed an additional $35,000 of section 179 expensing for qualified renewal property placed in service after December 31, 2000, and before January 1, 2008. 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). The section 179 expensing allowed to a taxpayer is phased out by the amount by which 50 percent of the cost of qualified renewal property placed in service during the year by the taxpayer exceeds $200,000. The term qualified renewal property" is similar to "qualified zone property" under section 1397C.

Expensing of environmental remediation costs ("brownfields").—A renewal community is treated as a "targeted area" under section 198 which permits expensing of certain environmental remediation costs. Thus, taxpayers can elect to treat certain environmental remediation expenditures that otherwise would be capitalized 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 applies to expenditures incurred after December 31, 2000, and before January 1, 2008.

Extension of work opportunity tax credit ("WOTC").—The provision makes two changes to the WOTC. Beginning in 2001, the provision expands the high-risk youth and qualified summer youth categories in the present-law WOTC to include qualified individuals who live in a renewal community. Second, in the event that the WOTC program were to expire and not be extended, the bill permits employers engaged in a trade or business in a renewal community to claim a tax credit 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 tax credit equals 15 percent of the qualified first-year wages and 30 percent of the qualified second-year wages through December 31, 2007. No more than $10,000 of wages may be taken into account in each year. Qualified wages generally consist of wages paid or incurred during the period for which the WOTC is being calculated.

Targeted groups eligible for the tax credit include: (1) certain individuals certified by the designated local agency as being a member of a family receiving assistance under a IV–A program for any nine months during the 18-month period ending on the hiring date; (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 receiv-

ing 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 Supplemental Security Income benefits.

HUD reports.—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 HUD 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

Although renewal communities would be designated within 24 months after publication of regulations by HUD, the tax benefits available in renewal communities are effective for the 7-year period beginning January 1, 2001, and ending December 31, 2007.

Senate Amendment

No provision.

Conference Agreement

The conference agreement generally follows the House bill with the following modifications. The conference agreement does not provide for the designation of the "FDA matching demonstration areas." In addition, the conference agreement does not include the provision requiring a report by the Secretary of HUD to Congress.

B. Provide That Federal Production Payments to Farmers Are Taxable in the Year Received (sec. 711 of the House bill)

Present Law

A taxpayer generally is required to include an item in income no later than the time of its actual or constructive receipt, unless such amount properly is accounted for in 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 (the "FAIR Act") provides for production flexibility contracts between certain eligible owners and producers and the Secretary of Agriculture. These contracts generally cover crop years from 1996 through 2002. Annual payments are made under such contracts at specific times during the Federal government's fiscal year. Section 112(d)(2) of the FAIR Act provides that one-half of each annual

payment is to be made on either December 15 or January 15 of the fiscal year, at the option of the recipient.[50] The remaining one-half of the annual payment must be made no later than September 30 of the fiscal year. The Emergency Farm Financial Relief Act of 1998 added section 112(d)(3) to the FAIR Act which 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. Thus, the one-half of the annual amount that would otherwise be required to be paid no later than September 30, 1999 can be specified for payment in calendar year 1998.

These options potentially would have resulted in the constructive receipt (and thus inclusion in income) of the payments to which they relate at the time they could have been exercised, whether or not they were in fact exercised. However, section 2012 of the Tax and Trade Relief Extension Act of 1998 provided that the time a production flexibility contract payment under the FAIR Act properly is includible in income is to be determined without regard to either option, effective for production flexibility contract payments made under the FAIR Act in taxable years ending after December 31, 1995.

House Bill

Any option to accelerate the receipt of any payment under a production flexibility contract which is payable under the FAIR Act, as in effect on the date of enactment of the provision, is to be disregarded in determining the taxable year in which such payment is properly included in gross income. Options to accelerate payments that are enacted in the future are covered by this rule, providing the payment to which they relate is mandated by the FAIR Act as in effect on the date of enactment of this Act.

The provision does not delay the inclusion of any amount in gross income beyond the taxable period in which the amount is received.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

C. Allow Net Operating Losses from Oil and Gas Properties To Be Carried Back for Up to Five Years (sec. 721 of the House bill, sec. 1104 of the Senate amendment, and sec. 172 of the Code)

Present Law

A net operating loss ("NOL") generally is the amount by which business deductions of a taxpayer exceed business gross income. In

[50] This rule applies to fiscal years after 1996. For fiscal year 1996, this payment was to be made not later than 30 days after the production flexibility contract was entered into.

general, an NOL may be carried back two years and carried forward 20 years to offset taxable income in such years. A carryback of an NOL results in the refund of Federal income tax for the carryback year. A carryforward of an NOL reduces Federal income tax for the carryforward year. Special NOL carryback rules apply to (1) casualty and theft losses of individual taxpayers, (2) Presidentially declared disasters for taxpayers engaged in a farming business or a small business, (3) real estate investment trusts, (4) specified liability losses, (5) excess interest losses, and (6) farm losses.

House Bill

The House bill provides a special five-year carryback for certain eligible oil and gas losses. The carryforward period remains 20 years. An "eligible oil and gas loss" is defined as the lesser of (1) the amount which would be the taxpayer's NOL for the taxable year if only income and deductions attributable to operating mineral interests in oil and gas wells were taken into account, or (2) the amount of such net operating loss for such taxable year. In calculating the amount of a taxpayer's NOL carrybacks, the portion of the NOL that is attributable to an eligible oil and gas loss is treated as a separate NOL and taken into account after the remaining portion of the NOL for the taxable year.

Effective date.—The provision applies to net operating losses arising in taxable years beginning after December 31, 1998.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

D. Deduction for Delay Rental Payments (sec. 722 of the House bill, sec. 1106 of the Senate amendment, and sec. 263A of the Code)

Present Law

Present law generally requires costs associated with inventory and property held for resale to be capitalized rather than currently deducted as they are incurred. (sec. 263). Oil and gas producers typically contract for mineral production in exchange for royalty payments. If mineral production is delayed, these contracts provide for "delay rental payments" as a condition of their extension. The Treasury Department has taken the position that the uniform capitalization rules of section 263A require delay rental payments to be capitalized.

House Bill

The House bill allows delay rental payments to be deducted currently.

Effective date.—The provision applies to rental payments incurred in taxable years beginning after December 31, 1999.

No inference is intended from the prospective effective date of this provision as to the proper treatment of pre-effective date delay rental payments.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

E. Election to Expense Geological and Geophysical Expenditures (sec. 723 of the House bill, sec. 1105 of the Senate amendment, and sec. 263 of the Code)

Present Law

Under present law, current deductions are not allowed for any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or estate (sec. 263(a)). Treasury Department regulations define capital amounts to include amounts paid or incurred (1) to add to the value, or substantially prolong the useful life, of property owned by the taxpayer or (2) to adapt property to a new or different use.[51]

The proper income tax treatment of geological and geophysical costs ("G&G costs") associated with oil and gas production has been the subject of a number of court decisions and administrative rulings. G&G costs are incurred by the taxpayer for the purpose of obtaining and accumulating data that will serve as a basis for the acquisition and retention of oil or gas properties by taxpayers exploring for the minerals. Courts have ruled that such costs are capital in nature and are not deductible as ordinary and necessary business expenses.

House Bill

The House bill allows geological and geophysical costs incurred in connection with oil and gas exploration in the United States to be deducted currently.

Effective date.—The provision is effective for G&G costs incurred in taxable years beginning after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

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[51] Treas. Reg. sec. 1.263(a)–(1)(b).

F. Temporary Suspension of Limitation Based on 65 Percent of Taxable Income (sec. 724 of the House bill and sec. 613 of the Code)

Present Law

Depletion, like depreciation, is a form of capital cost recovery. In both cases, the taxpayer is allowed a deduction in recognition of the fact that an asset—in the case of depletion for oil or gas interests, the mineral reserve itself—is being expended in order to produce income. Certain costs incurred prior to drilling an oil or gas property are recovered through the depletion deduction. These include costs of acquiring the lease or other interest in the property and geological and geophysical costs (in advance of actual drilling). Depletion is available to any person having an economic interest in a producing property.

Two methods of depletion currently are allowable under the Code: (1) the cost depletion method, and (2) the percentage depletion method (secs. 611–613). Under the cost depletion method, the taxpayer deducts that portion of the adjusted basis of the depletable property which is equal to the ratio of units sold from that property during the taxable year to the number of units remaining as of the end of taxable year plus the number of units sold during the taxable year. Thus, the amount recovered under cost depletion may never exceed the taxpayer's basis in the property.

Under the percentage depletion method, generally, 15 percent of the taxpayer's gross income from an oil- or gas-producing property is allowed as a deduction in each taxable year (sec. 613A(c)). The amount deducted generally may not exceed 100 percent of the net income from that property in any year (the "net-income limitation") (sec. 613(a)).[52] Additionally, the percentage depletion deduction for all oil and gas properties may not exceed 65 percent of the taxpayer's overall taxable income (determined before such deduction and adjusted for certain loss carrybacks and trust distributions) (sec. 613A(d)(1)).

House Bill

The limit on percentage depletion deductions to no more than 65 percent of the taxpayer's overall taxable income is suspended for taxable years beginning after December 31, 1998, and before January 1, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

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[52] The Taxpayer Relief Act of 1997 suspended the 100-percent net-income limitation for production from marginal wells for taxable years beginning after December, 31, 1997, and before January 1, 2000. This suspension is extended for an additional period, through December 31, 2004, in another section of the House bill and the Senate amendment.

G. Modify Small Refiner Limit for Eligibility for Percentage Depletion Deductions (sec. 725 of the House bill and sec. 613A of the Code)

Present Law

Present law classifies oil and gas producers as independent producers or integrated companies. The Code provides numerous different, and typically more generous, tax rules for operations by independent producers. One such rule allows independent producers to claim percentage depletion deductions rather than deducting the costs of their asset, a producing well, based on actual production from the well (i.e., cost depletion).

A producer is an independent producer only if its refining and retail operations are relatively small. For example, an independent producer may not have refining operations the runs from which exceed 50,000 barrels on any day in the taxable year during which independent producer status is claimed.

House Bill

The House bill changes the refinery limitation on claiming independent producer status from a limit based on actual daily production to a limit based on average daily production for the taxable year: the average daily refinery run for the taxable year may not exceed 50,000 barrels. For this purpose, the taxpayer shall calculate average daily production by dividing total production for the taxable year by the total number of days in the taxable year.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

H. Increase the Maximum Dollar Amount of Reforestation Expenditures Eligible for Amortization and Credit (sec. 731 of the House bill, sec. 1108 of the Senate amendment, and sec. 194 of the Code)

Present Law

Amortization of reforestation costs (sec. 194)

A taxpayer may elect to amortize up to $10,000 ($5,000 in the case of a separate return by a married individual) of qualifying reforestation expenditures incurred during the taxable year with respect to qualifying timber property. Amortization is taken over 84 months (7 years) and is subject to a mandatory half-year convention.[53] In the case of an individual, the amortization deduction is

[53] Under the half-year convention, all reforestation expenditures are considered to be incurred on the first day of the first month of the second half of the taxable year. Thus, an amortization deduction equal to 6/84 of the expenditures for the year is allowed in the first and eighth

allowed in determining adjusted gross income (an above-the-line deduction) rather than as an itemized deduction. The amount eligible for amortization has not been increased since the election was added to the Code in 1980.[54]

Qualifying reforestation expenditures are the direct costs a taxpayer incurs in connection with the forestation or reforestation of a site by planting or seeding, and include costs for the preparation of the site, the cost of the seed or seedlings, and the cost of the labor and tools (including depreciation of long lived assets such as tractors and other machines) used in the reforestation activity. Qualifying reforestation expenditures do not include expenditures that would otherwise be deductible and do not include costs for which the taxpayer has been reimbursed under a governmental cost sharing program, unless the amount of the reimbursement is also included in the taxpayer's gross income.

Qualifying timber property includes any woodlot or other site that is located in the United States that will contain trees in significant commercial quantities and that is held by the taxpayer for the planting, cultivating, caring for, and cutting of trees for sale or use in the commercial production of timber products. The regulations require that the site consist of at least one acre that is devoted to such activities.[55] A taxpayer may hold qualifying timber property in fee or by lease. Where the property is held by one person for life with the remainder to another person, the life tenant is considered the owner of the property for this purpose.

Reforestation amortization is subject to recapture as ordinary income on sale of qualifying timber property within 10 years of the year in which the qualifying reforestation expenditures were incurred.[56]

Reforestation tax credit (sec. 48(b))

A tax credit is allowed equal to 10 percent of the reforestation expenditures incurred during the year that are properly elected to be amortized. An amount allowed as a credit is subject to recapture if the qualifying timber property to which the expenditure relates is disposed of within 5 years.

House Bill

The provision increases the amount of reforestation expenditures eligible for 7-year amortization and the reforestation credit from $10,000 to $25,000 per taxable year (from $5,000 to $12,500 in the case of a separate return by a married individual).

For taxable years beginning in 2000 through 2003, the provision removes the limitation on the amount eligible for 7-year amortization.

Effective date.—The provision is effective for expenditures paid or incurred in taxable years beginning after December 31, 1998. Expenditures paid or incurred prior to the effective date would continue to be recovered under the rules of present law. For taxable

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years and an amortization deduction equal to 1/7 (12/84) of such expenditures is allowed in the second through seventh years.

[54] Sec. 301(a) of the Multiemployer Pension Plan Amendments Act of 1980.

[55] Treas. Reg. sec. 1.194–3(a).

[56] Sec. 1245(b)(7); Treas. Reg. sec. 1.194–1(c).

years beginning in 1999 and after 2003, the amount of reforestation expenditures eligible for 7-year amortization and for the credit is limited to $25,000. For taxable years beginning in 2000 through 2003, the amount of reforestation expenditures eligible for the credit is limited to $25,000 and no limit would apply to the amount eligible for 7-year amortization.

Senate Amendment

The Senate amendment is generally the same as the House bill, except that the Senate amendment is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, effective as provided in the Senate amendment. Accordingly, there is no change in the amount of reforestation expenditures eligible for amortization and the credit for taxable years beginning in 1999. For taxable years beginning in 2000 through 2003, the amount of reforestation expenditures eligible for the credit is limited to $25,000 and no limit applies to the amount eligible for 7-year amortization. For taxable years beginning after 2003, the amount of reforestation expenditures eligible for 7-year amortization and for the credit is limited to $25,000.

I. Capital Gains Treatment Under Section 631(b) to Apply to Outright Sales by Landowners (sec. 732 of the House bill, sec. 1136 of the Senate amendment, and sec. 631(b) of the Code)

Present Law

Gain on the cutting and sale of timber generally is eligible for capital gains treatment, provided the growing timber has been held for more than one year. If the taxpayer sells the timber at the time it is cut, the capital gain is measured as the difference between the sales price of the timber less cost of sales and any unrecovered costs of growing the timber.

If the taxpayer sells the timber prior to its being cut, a special rule allows the taxpayer to treat the sale as a capital gain, provided the taxpayer retains an economic interest in the timber and holds the timber for more than one year prior to the date of disposal. The date of disposal is deemed to be the date the timber is cut, unless the taxpayer receives payment for the timber prior to the date it is cut and elects to treat the date of payment as the date of disposal.

House Bill

In the case of a sale of timber by the owner of the land from which the timber is cut, the requirement that a taxpayer retain an economic interest in the timber in order to treat gains on sales prior to the time the timber is cut as capital gains does not apply. Outright sales of timber by the landowner will qualify for capital gains treatment in the same manner as sales with a retained economic interest qualify under present law. The provision does not

modify the rule that deems the date of cutting to be the date of disposition. Thus, unless the taxpayer receives payment prior to the date of cutting and elects to treat that date as the date of disposition, the date of sale will be the date of cutting whether or not an economic interest is retained.

Effective date.—The provision is effective for sales of timber after the date of enactment. A sale will not be considered to occur after the date of enactment if the taxpayer conveys its interest in the timber on or before the date of enactment, even if the deemed date of disposition is after the date of enactment.

Senate Amendment

Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

J. Minimum Tax Relief for the Steel Industry (sec. 741 of the House bill and sec. 53 of the Code)

Present Law

A corporate taxpayer receives a minimum tax credit for any year in which it pays alternative minimum tax. The alternative minimum tax is the excess of tentative minimum tax over regular tax[57] and generally represents the additional tax a corporate taxpayer is required to pay in any year as a result of the alternative minimum tax system. The minimum tax credit may be used in future years to the extent regular tax exceeds tentative minimum tax. The minimum tax credit may not be used to reduce liability below tentative minimum tax. The credit may be carried forward indefinitely.

For example, a corporate taxpayer has $1,000 of minimum tax credits available in a year in which its regular tax is $200 and its tentative minimum tax is $100. The taxpayer may use $100 of its minimum tax credits (the excess of regular tax over tentative minimum tax) to reduce its current liability to $100. The taxpayer would then have $900 of minimum tax credits available in the following year.

If instead the corporate taxpayer had regular tax of $100 and tentative minimum tax of $200, it would not be allowed to use any of its minimum tax credits because there is no excess of regular tax over tentative minimum tax. The taxpayer would have a current liability of $200 ($100 of regular tax and $100 of alternative minimum tax) and would generate an additional $100 of minimum tax credits, giving it minimum tax credits of $1100 available for the following year.

[57] For this purpose, tentative minimum tax is determined net of alternative minimum tax foreign tax credits and regular tax is determined net of regular tax foreign tax credits.

House Bill

The provision allows minimum tax credits to offset 90 percent of tentative minimum tax[58] in the case of a steel company, in addition to any excess of regular tax over tentative minimum tax. The benefit of the provision is limited to amounts that are attributable to the trade or business of manufacturing steel within the United States for sale to customers. The rules regarding the determination of minimum tax credits are not changed. The Secretary is authorized to issue regulations to insure that the benefit of the provision is limited to steel companies.

For example, under the provision, a company that has exclusively engaged in the trade or business of manufacturing steel within the United States for sale to customers has $1,000 of minimum tax credits available in a year in which its regular tax is $200 and its tentative minimum tax is $100. The taxpayer may use minimum tax credits of $100 (the excess of its regular tax over its tentative minimum tax) plus $90 (90 percent of its tentative minimum tax), for a total of $190, to reduce its current liability to $10. The taxpayer would then have $810 of minimum tax credits available in the following year.

If instead the steel company had regular tax of $100 and tentative minimum tax of $200, it would be allowed to use $180 (90 percent of its tentative minimum tax) of its minimum tax credits to reduce its current liability to $20. The net effect on its minimum tax credits would be a reduction of $80,[59] giving it minimum tax credits of $920 available for the following year.

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

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

VIII. SMALL BUSINESS TAX RELIEF PROVISIONS

A. Accelerate 100-Percent Self-Employed Health Insurance Deduction (sec. 801 of the House bill, sec. 601 of the Senate amendment, and sec. 162(l) of the Code)

Present Law

Under present law, the tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed in-

[58] Determined net of the alternative minimum tax foreign tax credit.

[59] The determination of minimum tax credits available in the following year is a multiple step process, involving an increase in the stock of minimum tax credits by the amount that tentative minimum tax exceeds regular tax ($100), combined with a reduction by the amount used ($180), for a net reduction of $80.

dividual is 60 percent in 1999 through 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the taxpayer is eligible to participate in a subsidized health plan maintained by the employer of the taxpayer or the taxpayer's spouse.

The self-employed health deduction also applies to qualified long-term care insurance premiums treated as medical care for purposes of the itemized deduction for medical expenses.

House Bill

Beginning in 2000, the House bill increases the deduction for health insurance expenses (and qualified long-term care insurance expenses) of self-employed individuals to 100 percent.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill, except that the Senate amendment also provides that the self-employed health deduction is not available for any month in which the taxpayer participates in any subsidized health plan maintained by any employer of the taxpayer or the taxpayer's spouse.

Effective date.—Same as the House bill.

Conference Agreement

The conference agreement follows the Senate amendment. Under the conference agreement, as under the Senate amendment, the self-employed health deduction is not available for any month in which the taxpayer participates in any subsidized health plan maintained by any employer of the taxpayer or the taxpayer's spouse. Thus, for example, suppose that A is a sole proprietor and that A and his spouse, S, are eligible to participate in the health plan sponsored by S's employer, but decline to participate. A and S are entitled to the self-employed health deduction.

Effective date.—Taxable years beginning after December 31, 1999.

B. Increase Section 179 Expensing (sec. 802 of the House bill, sec. 602 of the Senate amendment, 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 $19,000 (for taxable years beginning in 1999) 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 $19,000 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 $19,000 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 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.

House Bill

The House bill provides that the maximum dollar amount that may be deducted under section 179 is increased to $30,000 for taxable years beginning in 2000 and thereafter, without the present-law phase-in rule.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Repeal of Temporary Federal Unemployment Surtax (sec. 803 of the House bill, sec. 603 of the Senate amendment and sec. 3301 of the Code)

Present Law

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2-percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4-percentage points against the 6.2-percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent. Since all States currently have approved programs, 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the unemployment system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States use the revenue turned back to them by the 5.4-percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8-percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through 2007.

House Bill

The House bill repeals the temporary FUTA surtax after December 31, 2004.

Effective date.—The House bill provision is effective for labor performed on or after January 1, 2005.

Senate Amendment

Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

D. Farmer and Fisherman Income Averaging (sec. 604 of the Senate amendment and secs. 55(c) and 1301 of the Code)

Present Law

An individual taxpayer may elect to compute his or her current year tax liability by averaging, over the prior three-year period, all or portion of his or her taxable income from the trade or business of farming. The averaging election is not coordinated with the alternative minimum tax. Thus, some farmers may become subject to the alternative minimum tax solely as a result of the averaging election.

House Bill

No provision.

Senate Amendment

The election to average income is extended to cover income from the trade or business of fishing as well as farming. For this purpose, the trade or business of fishing is the conduct of commercial fishing as defined in Section 3 of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802) and includes the trade or business of catching, taking or harvesting fish that are intended to enter commerce through sale, barter or trade.

The provision coordinates farmers' and fishermen's income averaging with the alternative minimum tax. A farmer or fisherman electing to average his or her farm income will owe alternative minimum tax only to the extent he or she would have owed alternative minimum tax had averaging not been elected. This is achieved by excluding the impact of the election to average farm income from the calculation of both regular tax and tentative minimum tax, solely for the purpose of determining alternative minimum tax.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

E. Farm, Fish and Ranch Risk Management Accounts (sec. 605 of the Senate amendment and secs. 468C and 4973 of the Code)

Present Law

There is no provision in present law allowing the elective deferral of farm or fishing income.

House Bill

No provision.

Senate Amendment

The bill allows taxpayers engaged in an eligible business to establish Farm, Fish and Ranch Risk Management (FFARRM) accounts. An eligible business is any trade or business of farming in which the taxpayer actively participates, including the operation of a nursery or sod farm or the raising or harvesting of crop-bearing or ornamental trees[60]. An eligible business is also the trade or business of commercial fishing as that term is defined under section (3) of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802) and includes the trade or business of catching, taking or harvesting fish that are intended to enter commerce through sale, barter or trade.

Contributions to a FFARRM account are deductible and are limited to 20 percent of the taxable income that is attributable to the eligible business. The deduction is to be taken into account in determining adjusted gross income and will reduce income attributable to the eligible business for all income tax purposes other than the determination of the 20 percent of eligible income limitation on contributions to a FFARRM account. Contributions will be deemed to have been made on the last day of the taxable year if made on or before the due date (without regard to extensions) of the taxpayer's return for that year.

A FFARRM account is taxed as a grantor trust and any earnings are required to be distributed currently. Thus, any income earned in the FFARRM account is taxed currently to the farmer or fisherman who established the account.

Contributions to a FFARRM account do not reduce earnings from self-employment. Accordingly, distributions are not included in self-employment income.

Amounts may remain on deposit in a FFARRM account for up to five years. Any amount that has not been distributed by the close of the fourth year following the year of deposit is deemed to be distributed and includible in the gross income of the account owner. Distributions for the year are considered to first be made from the earnings that are required to be distributed. Additional amounts distributed for the year are considered to be made from the oldest deposits.

Distributions from a FFARRM account may not be used to purchase, lease, or finance any new fishing vessel, add capacity to any

[60] An evergreen tree that is more than 6 years old when severed from the roots (and thus eligible for captial gains treatment on cutting) is not considered an ornamental tree for this purpose.

fishery, or otherwise contribute to the overcapitalization of any fishery. The Secretary of Commerce shall implement regulations enforcing this restriction.

A FFARRM account may not be maintained by a taxpayer who has ceased to engage in an eligible business. If the taxpayer does not engage in an eligible business during two consecutive taxable years, the balance in the FFARRM account is deemed to be distributed to the taxpayer on the last day of such two year period.

If the taxpayer who established the FFARRM account dies, and the taxpayer's surviving spouse acquires the taxpayer's interest in the FFARRM account by reason of being designated as the beneficiary of the account at the death of the taxpayer, the surviving spouse will "step into the shoes" of the deceased taxpayer with respect to the FFARRM account. In other cases, the account will cease to be a FFARRM account on the date of the taxpayer's death and the balance in the account will be deemed distributed to the taxpayer on the date of death.

A FFARRM account is a trust that is created or organized in the United States for the exclusive benefit of the taxpayer who establishes it. The trustee must be a bank or other person who demonstrates to the satisfaction of the Secretary that it will administer the trust in a manner consistent with the requirements of the section. At all times, the assets of the trust must consist entirely of cash and obligations which have adequate stated interest (as defined in section 1274(c)(2)) and which pay such adequate interest not less often than annually. The trust must distribute all income currently, and its assets may not be commingled except in a common trust fund or common investment fund. Additional protections, including rules preventing the trust from engaging in prohibited transactions or from being pledged as security for a loan, are provided.

Penalties apply in the case of excess contributions and failures to make required distributions.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

F. S Corporation Bank Provisions

1. Definition of passive investment income for banks (sec. 606 of the Senate amendment and sec. 1362 of the Code)

Present Law

An S corporation is subject to corporate-level tax, at the highest marginal corporate tax rate, on its net passive income if the corporation has (1) accumulated earnings and profits[61] at the close of the taxable year and (2) gross receipts more than 25 percent of which are passive investment income. In addition, an S corporation election is terminated whenever the corporation has accumulated C

[61] An S corporation generally will have accumulated corporation earnings and profits if it had been a C corporation prior to electing to be an S corporation.

earnings and profits at the close of three consecutive taxable years and has gross receipts for each of such years more than 25 percent of which are passive investment income.

For these purposes, "passive investment income" generally means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities (to the extent of gains).

Treasury regulations provide that passive income does not include gross receipts directly derived in the ordinary course of a trade or business of lending or financing.[62] The Internal Revenue Service has ruled that income earned by an S corporation on specified banking assets will be treated as gross receipts directly derived from the active and regular conduct of a banking business.[63]

House Bill

No provision.

Senate Amendment

The Senate amendment provides that, for purposes of applying the passive income test to a bank or a bank holding company, interest income and dividends received on assets required to conduct a banking business are not to be treated as passive income.

Effective date.—The provision applies to taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

2. Bank director stock (sec. 607 of the Senate amendment and sec. 1361 of the Code)

Present Law

The taxable income or loss of an S corporation is taken into account by the corporation's shareholders, rather than by the entity, whether or not such income is distributed. A small business corporation may elect to be treated as an S corporation. A "small business corporation" generally is defined as a domestic corporation which does not have (1) more than 75 shareholders; (2) a shareholder (other than certain trusts, estates, and tax-exempt organizations) who is not an individual; (3) a nonresident alien as a shareholder; and (4) more than one class of stock.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, qualifying director shares is not treated as a second class of stock. Instead, payments on the stock are deductible by the corporation and includible in income of the

[62] Treas. Regulation sec. 1–1362–2(c)(5)(iii)(B).
[63] Notice 97–5, 1997–1 C. B. 352 (January 13, 1997).

holder of the stock. No allocations of income or loss are made with respect to the stock. Qualifying director shares are shares of stock in a bank or bank holding company that are held by an individual solely by reason of being a director and which are subject to an agreement to dispose of the shares upon termination of director status at the price paid to acquire the shares.

Effective date.—The provision applies to taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

IX. INTERNATIONAL TAX RELIEF PROVISIONS

A. Allocate Interest Expense on Worldwide Basis (sec. 901 of the House bill, sec. 901 of the Senate amendment, and sec. 864 of the Code)

Present Law

In general

In order to compute the foreign tax credit limitation, a taxpayer must determine the amount of taxable income from foreign sources. Thus, the taxpayer must allocate and apportion deductions between items of U.S.-source gross income, on the one hand, and items of foreign-source gross income, on the other. Generally, it is left to the Treasury to provide detailed rules for the allocation and apportionment of expenses.

In the case of interest expense, regulations generally are based on the approach that money is fungible and that interest expense is properly attributable to all business activities and property of a taxpayer, regardless of any specific purpose for incurring an obligation on which interest is paid. (Exceptions to the fungibility concept are recognized or required, however, in particular cases, some of which are described below.) The Code provides that for interest allocation purposes all members of an affiliated group of corporations generally are to be treated as a single corporation (the so-called "one-taxpayer rule"), and that allocation must be made on the basis of assets rather than gross income.

Affiliated group

In general

The term "affiliated group" in this context generally is defined by reference to the rules for determining whether corporations are eligible to file consolidated returns. However, some groups of corporations are eligible to file consolidated returns yet are not treated as affiliated for interest allocation purposes, and other groups of corporations are treated as affiliated for interest allocation purposes even though they are not eligible to file consolidated returns. Thus, under the one-taxpayer rule, the factors affecting the allocation of interest expense of one corporation may affect the sourcing of taxable income of another, related corporation even if the two corporations do not elect to file, or are ineligible to file, consolidated returns. (See, e.g., Treas. Reg. sec. 1.861–11T(g).)

Definition of affiliated group—consolidated return rules

For consolidation purposes, the term "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation, but only if the common parent owns directly at least 80 percent of the total voting power of all classes of stock and at least 80 percent of the total value of all outstanding stock of at least one other includible corporation. In addition, for each such other includible corporation (except the common parent), stock possessing at least 80 percent of the total voting power of all classes of its stock and at least 80 percent of the total value of all of its outstanding stock must be directly owned by one or more other includible corporations.

Generally the term "includible corporation" means any domestic corporation except certain corporations exempt from tax under section 501 (for example, corporations organized and operated exclusively for charitable or educational purposes), certain life insurance companies, corporations electing application of the possession tax credit, regulated investment companies, real estate investment trusts, and domestic international sales corporations. A foreign corporation generally is not an includible corporation.

Definition of affiliated group—special interest allocation rules

Subject to exceptions, the consolidated return and interest allocation definitions of affiliation generally are consistent with each other.[64] For example, both definitions exclude all foreign corporations from the affiliated group. Thus, while debt generally is considered fungible among the assets of a group of domestic affiliated corporations, the same rule does not apply as between the domestic and foreign members of a group with the same degree of common control as the domestic affiliated group.

Banks, savings institutions and other financial affiliates

The affiliated group for interest allocation purposes generally excludes what are referred to in the regulations as "financial corporations" (Treas. Reg. sec. 1.861–11T(d)(4)). These include any corporation, otherwise a member of the affiliated group for consolidation purposes, that is a financial institution (described in section 581 or section 591), the business of which is predominantly with persons other than related persons or their customers, and which is required by State or Federal law to be operated separately from any other entity which is not a financial institution (sec. 864(e)(5)(C)). The category of financial corporations also includes, to the extent provided in regulations, bank holding companies, subsidiaries of banks and bank holding companies, and savings institutions predominantly engaged in the active conduct of a banking, financing, or similar business (sec. 864(e)(5)(D)).

A financial corporation is not treated as a member of the regular affiliated group for purposes of applying the one-taxpayer rule to other nonfinancial members of that group. Instead, all such fi-

[64] One such exception is that the affiliated group for interest allocation purposes includes section 936 corporations that are excluded from the consolidated group.

nancial corporations that would be so affiliated are treated as a separate single corporation for interest allocation purposes.

House Bill

Worldwide affiliated group election

The House bill modifies the present-law interest expense allocation rules (which generally apply for purposes of computing the foreign tax credit limitations) by providing a one-time election under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally would be determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis. The election provides taxpayers with the option either to apply fungibility principles on a worldwide basis or to continue to apply present law.

Under the House bill, the common parent of an affiliated group can make a one-time election to apply the present-law interest expense allocation and apportionment rules under section 864(e) by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group on a worldwide-group basis. If an affiliated group makes this election, subject to certain modifications and exceptions discussed below, the taxable income of the domestic members of the worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the interest expense of those domestic members to foreign-source income in an amount equal to the worldwide affiliated group's worldwide interest expense multiplied by a ratio of the foreign assets of the worldwide affiliated group over the total assets of the worldwide affiliated group.

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group (as that term is defined under present law for interest expense allocation purposes)[65] as well as any foreign corporations with respect to which domestic members of the affiliated group own stock meeting the ownership requirements for treatment as a controlled foreign corporation under section 957(a) (without regard to the constructive ownership rules of section 958(b)). Hence, if more than 50 percent of the total combined voting power or the total value of the stock of a foreign corporation is owned (directly or indirectly) by domestic members of the affiliated group that are U.S. shareholders (i.e., that own 10 percent or more of the total combined voting power of the stock of such foreign corporation), then such foreign corporation is included in an electing worldwide affiliated group.

With respect to foreign corporations included in a worldwide affiliated group, the House bill provides that only a pro rata portion of such foreign corporation's interest expense and assets is treated as attributable to the worldwide affiliated group and taken into account for purposes of determining the allocation and apportionment

[65] The bill expands the present-law definition of an affiliated group for interest expense allocation purposes to include certain insurance companies that are generally excluded from an affiliated group under section 1504(b)(2) (without regard to whether such companies are covered by an election under section 1504(c)(2)). As is the case under present law, the affiliated group includes section 936 corporations.

of interest expense. The pro rata portion is determined by the ratio of the value of the stock of the foreign corporation owned by domestic members of the worldwide affiliated group (regardless of whether the foreign corporation qualifies as more than 50-percent owned because of either vote or value) to the total value of the stock of such foreign corporation.

In short, the taxable income from sources outside the United States of electing domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group under present-law section 864(e)(5)(A) as modified to include insurance companies) and a pro rata portion of the interest expense and assets of greater than 50-percent owned foreign subsidiaries were attributable to a single corporation.

Although a pro rata portion of the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return. After calculating the interest expense allocation based on the worldwide affiliated group, the interest expense of the domestic members preliminarily allocable to foreign-source income is reduced (but not below zero) by the applicable pro rata portion of the interest expense incurred by a foreign member of the group to the extent that such interest would be allocated to foreign sources if the provision's principles were applied separately to the foreign members of the group.

The worldwide affiliated group election is to be made by the common parent of the affiliated group. It must be made for the first taxable year beginning after December 31, 2001 (the effective date under the House bill), in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election was made and all subsequent taxable years.

Annual elections

Regardless of whether a taxpayer elects to continue to be governed by the present-law allocation rules or to apply the new worldwide fungibility principle, the House bill provides two annual elections that are exceptions to the "one-taxpayer" rule described above: (1) the "subsidiary group" election, and (2) a "financial institution group" election.

Subsidiary group election

Under the subsidiary group election, at the annual election of the common parent of the affiliated group, certain interest expense attributable to qualified indebtedness incurred by a domestic member of the affiliated group (other than the common parent) is allocated and apportioned by treating the borrower and its direct and indirect subsidiaries as a separate group (in which the borrower

would be treated as the common parent). The regime that is elected by the entire affiliated group (i.e., present law or the worldwide fungibility principles of the House bill) applies to all the qualified indebtedness of the members of that separate electing subsidiary group. For this purpose, qualified indebtedness generally means any borrowing from unrelated parties that is not guaranteed or in any other way supported by any corporation within the same affiliated group (other than a member of the subsidiary group) of the borrower.

If the common parent of the affiliated group makes the election with respect to a domestic member of an affiliated group, the subsidiary group election applies to all direct and indirect subsidiaries of that member. No member of an electing subsidiary group can be treated as a member of another electing subsidiary group. Therefore, a separate subsidiary group election could not be made with respect to lower-tier subsidiaries in an electing subsidiary group. If the subsidiary group election is made, the House bill also provides that an "equalization" rule applies under which interest expense (if any) incurred by domestic members of the affiliated group with respect to indebtedness that is not qualified indebtedness of an electing subsidiary group is allocated first to foreign-source income to the extent necessary to achieve (if possible) the allocation and apportionment of interest expense to foreign-source income that would have resulted had the subsidiary group election not been made. In addition, the House bill provides anti-abuse rules under which certain transfers from one member of a subsidiary group to a member of the affiliated group outside of the subsidiary group are treated as reducing the amount of qualified indebtedness.

Financial institution group election

The House bill provides a financial institution group election that expands and replaces the bank group rules of present law (sec. 864(e)(5)(B)–(D)). At the annual election of the common parent of the affiliated group, the interest expense allocation and apportionment rules that apply to the affiliated group as a whole (i.e., present law or the worldwide approach), can be applied separately to a subgroup of the affiliated group consisting of corporations that are predominantly engaged in a banking, insurance, financing, or similar business (as well as certain bank holding companies). For this purpose, a corporation is predominantly engaged in such a business if at least 80 percent of its gross income is "financial services income" as described in section 904(d)(2)(C)(ii) and the regulations thereunder.[66] The financial institution group rules, if elected, apply to all members of the affiliated group that are considered to be predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, or otherwise considered to be a bank holding company. In addition, if a financial institution group election has been made, a member of the affiliated group that is part of the financial institution group could not also be a member of a separate subsidiary group at the same time. Anti-abuse rules similar to those that apply in connection with the subsidiary group election also apply to the financial institution group.

[66] See Treas. Reg. sec. 1.904–4(e)(2).

Regulatory authority

The House bill grants the Treasury Secretary authority to prescribe rules to carry out the purposes of the provision, including rules (1) to address changes in members of an affiliated group (including acquisitions or other business combinations of affiliated groups in which one group has made an election to apply the worldwide approach and the other group applies present law); (2) to prevent assets and interest expense from being taken into account more than once; and (3) to provide for direct allocation of interest expense in circumstances where such allocation would be appropriate to carry out the purposes of the provision.

Effective date

The provision in the House bill is effective for taxable years beginning after December 31, 2001.

Senate Amendment

The Senate amendment generally follows the House bill, but makes the following modifications.

Worldwide affiliated group election

The Senate amendment follows the House bill in that the common parent of an affiliated group can make a one-time election to apply the present-law interest expense allocation and apportionment rules under section 864(e) by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group on a worldwide-group basis. If an affiliated group makes this election, subject to certain modifications and exceptions, the taxable income of the domestic members of the worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide interest expense multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group, over (2) the interest expense incurred by a foreign member of the group to the extent that such interest would be allocated to foreign sources if the provision's principles were applied separately to the foreign members of the group.[67] While this approach is generally the same as that under the House bill, the Senate amendment modifies the House bill to provide the actual allocation and apportionment formula in the statute.

The Senate amendment modifies the House bill definition of a worldwide affiliated group for purposes of the new elective rules based on worldwide fungibility. Under the Senate amendment, the worldwide affiliated group means all corporations in an affiliated group (as that term is defined under present law for interest expense allocation purposes)[68] as well as any foreign corporations

[67] Although the interest expense of a foreign subsidiary is taken into account for purposes of allocating the interest expense of the domestic members of the electing worldwide affiliated group for foreign tax credit limitation purposes, the interest expense incurred by a foreign subsidiary is not deductible on a U.S. return.

[68] The Senate amendment follows the House bill by expanding the definition of an affiliated group for interest expense allocation purposes to include certain insurance companies that

that would be members of such an affiliated group if section 1504(b)(3) did not apply (i.e., in which at least 80 percent of the vote and value of the stock of such corporations is owned by one or more other corporations included in the affiliated group). In addition, unlike the House bill, the Senate amendment takes into account all of the interest expense and assets of foreign corporations that are part of an electing worldwide affiliated group rather than a pro rata portion. In short, under the Senate amendment, the taxable income from sources outside the United States of electing domestic group members generally is determined by allocating and apportioning interest expense of the domestic members of the worldwide affiliated group as if all of the interest expense and assets of 80-percent or greater owned domestic corporations (i.e., corporations that are part of the affiliated group under present-law section 864(e)(5)(A) as modified to include insurance companies) and 80-percent or greater owned foreign corporations were attributable to a single corporation.

The worldwide affiliated group election is to be made by the common parent of the affiliated group. It must be made for the first taxable year beginning after December 31, 2004 (the effective date under the Senate amendment), in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the worldwide affiliated group for the taxable year for which the election is made and all subsequent taxable years.

Subsidiary group election

The Senate amendment modifies the House bill to exclude the annual "subsidiary group" election.

Financial institution group election

The Senate amendment provides a "financial institution group" election that expands the bank group rules of present law (sec. 864(e)(5)(B)–(D)), but modifies the House bill by providing that this election is a one-time election as opposed to an annual election, and by providing that the election is only available to the extent that a worldwide affiliated group election has been made. Thus, unlike the House bill, under the Senate amendment the election would not be available to an affiliated group that continues to apply the present-law interest expense allocation rules.

Under the Senate amendment, at the election of the common parent of the affiliated group that has made the election to apply the worldwide affiliated group rules, those rules can be applied separately to a subgroup of the worldwide affiliated group that consists of (1) all corporations that are part of the present-law bank group and (2) all "financial corporations." For this purpose, the Senate amendment follows the House bill by providing that a corporation is a financial corporation if at least 80 percent of its gross

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are generally excluded from an affiliated group under section 1504(b)(2) (without regard to whether such companies are covered by an election under section 1504(c)(2)). The Senate amendment modifies this expansion, however, to apply only when the worldwide affiliated group election has been made.

income is "financial services income" (as described in section 904(d)(2)(C)(ii) and the regulations thereunder).[69] The Senate amendment modifies the House bill, however, by requiring that such income be derived from transactions with unrelated persons.

Under the Senate amendment, the financial institution group rules, if elected, apply to all members of the worldwide affiliated group that are financial corporations within the meaning of the provision. The election must be made for the first taxable year beginning after December 31, 2004, in which a worldwide affiliated group includes a financial corporation that would qualify as part of the expanded financial institution group (other than a corporation that would qualify as part of the present-law bank group). Once made, the election applies to the financial institution group for the taxable year and all subsequent taxable years. In addition, the Senate amendment provides anti-abuse rules under which certain transfers from one member of a financial institution group to a member of the worldwide affiliated group outside of the financial institution group are treated as reducing the amount of indebtedness of the separate financial institution group.

Effective date

The provision in the Senate amendment is effective for taxable years beginning after December 31, 2004.

Conference Agreement

The conference agreement generally follows the House bill with the following modifications.

Worldwide affiliated group election

The conference agreement modifies the present-law interest expense allocation rules by providing a one-time election under which the taxable income of the domestic members of an affiliated group from sources outside the United States generally would be determined by allocating and apportioning interest expense of the domestic members of a worldwide affiliated group on a worldwide-group basis. The election provides taxpayers with the option either to apply fungibility principles on a worldwide basis or to continue to apply present law. The conference agreement makes no changes to the present-law interest expense allocation rules; all aspects of the provision apply only to the extent that a worldwide affiliated group election is made.

Under the conference agreement, if an affiliated group makes the worldwide affiliated group election, subject to certain modifications and exceptions, the taxable income of the domestic members of the worldwide affiliated group from sources outside the United States is determined by allocating and apportioning the interest expense of those domestic members to foreign-source income in an amount equal to the excess (if any) of (1) the worldwide affiliated group's worldwide interest expense multiplied by the ratio which the foreign assets of the worldwide affiliated group bears to the total assets of the worldwide affiliated group, over (2) the interest expense incurred by a foreign member of the group (and taken into

[69] See Treas. Reg. sec. 1.904–4(e)(2).

account for allocation purposes) to the extent that such interest would be allocated to foreign sources if the provision's principles were applied separately to the foreign members of the group. While this approach is generally the same as that under the House bill, the conference agreement follows the Senate amendment by providing the actual allocation and apportionment formula in the statute.

For purposes of the new elective rules based on worldwide fungibility, the worldwide affiliated group means all corporations in an affiliated group (as that term is defined under present law for interest expense allocation purposes)[70] as well as any foreign corporations with respect to which domestic members of the affiliated group own stock meeting the ownership requirements for treatment as a controlled foreign corporation under section 957(a). For this purpose, the conference agreement modifies the House bill to permit limited constructive ownership rules (as described in section 958(b)) to apply. The conferees, however, believe that certain constructive ownership rules such as option attribution and "to-corporation" attribution (sec. 318(a)(3) and (4)) does not provide sufficient economic ownership to justify inclusion in the worldwide affiliated group. The conference agreement therefore disregards these types of constructive ownership. Hence, if more than 50 percent of the total combined voting power or the total value of the stock of a foreign corporation is owned (directly, indirectly, or, in certain circumstances, constructively) by domestic members of the affiliated group that are U.S. shareholders (i.e., that own 10 percent or more of the total combined voting power of the stock of such foreign corporation), then such foreign corporation is included in an electing worldwide affiliated group.

With respect to foreign corporations included in a worldwide affiliated group, the conference agreement follows the House bill in providing that only a pro rata portion of such foreign corporation's interest expense and assets is treated as attributable to the worldwide affiliated group and taken into account for purposes of determining the allocation and apportionment of interest expense. The pro rata portion is determined by the ratio of the value of the stock of the foreign corporation owned (within the meaning of section 958(a)) by domestic members of the worldwide affiliated group (regardless of whether the foreign corporation qualifies as more than 50-percent owned because of either vote or value) to the total value of the stock of such foreign corporation.

Under the conference agreement, the worldwide affiliated group election is to be made by the common parent of the affiliated group. It must be made for the first taxable year beginning after December 31, 2001 (the effective date under the conference agreement), in which a worldwide affiliated group exists that includes at least one foreign corporation that meets the requirements for inclusion in a worldwide affiliated group. Once made, the election applies to the common parent and all other members of the world-

[70] The conference agreement expands the present-law definition of an affiliated group for interest expense allocation purposes with respect to an electing worldwide affiliated group to include certain insurance companies that are generally excluded from an affiliated group under section 1504(b)(2) (without regard to whether such companies are covered by an election under section 1504(c)(2)). As is the case under present law, the affiliated group includes section 936 corporations.

wide affiliated group for the taxable year for which the election was made and all subsequent taxable years.

Additional elections

The conference agreement modifies the annual elections provided in the House bill as follows. To the extent that a worldwide affiliated group elects to apply the new worldwide fungibility principle, the conference agreement provides two additional elections that are exceptions to the "one-taxpayer" rule described above: (1) the "subsidiary group" election, and (2) the "financial institution group" election.

Subsidiary group election

Under the subsidiary group election, at the election of the common parent of the affiliated group, certain interest expense attributable to qualified indebtedness incurred by a domestic member of the affiliated group (other than the common parent) is allocated and apportioned by treating the borrower and its direct and indirect subsidiaries as a separate group (in which the borrower would be treated as the common parent). The conference agreement modifies the House bill by providing that election is only available to the extent that the affiliated group has elected the worldwide fungibility rules, and those rules apply to the qualified indebtedness of the members of that separate electing subsidiary group. For this purpose, qualified indebtedness generally means any borrowing from unrelated parties that is not guaranteed or in any other way supported by any corporation within the same worldwide affiliated group (other than a member of the subsidiary group) of the borrower.

If the common parent of the worldwide affiliated group makes the election with respect to a domestic member of an affiliated group, the subsidiary group election applies to all direct and indirect subsidiaries of that member. The conference agreement modifies the House bill to provide that the election, once made, applies to the taxable year and the four succeeding taxable years (unless revoked with the consent of the Treasury Secretary). The conferees are concerned with certain potentials for abuse and believe that a five-year period is a reasonable duration for which the subsidiary group election should apply. In addition, as under the House bill, no member of an electing subsidiary group can be treated as a member of another electing subsidiary group. Therefore, a separate subsidiary group election cannot be made with respect to lower-tier subsidiaries in an electing subsidiary group.

The conference agreement follows the House bill by providing that, if the subsidiary group election is made, an "equalization" rule applies under which interest expense (if any) incurred by domestic members of the worldwide affiliated group with respect to indebtedness that is not qualified indebtedness of an electing subsidiary group is allocated first to foreign-source income to the extent necessary to achieve (if possible) the allocation and apportionment of interest expense to foreign-source income that would have resulted had the subsidiary group election not been made. In addition, the conference agreement provides anti-abuse rules under which certain transfers from one member of a subsidiary group to

a member of the affiliated group outside of the subsidiary group would be recharacterized as reducing the amount of qualified indebtedness, except as otherwise provided by the Treasury Secretary.

Financial institution group election

The conference agreement generally follows the Senate amendment with respect to the financial institution group election, with certain technical modifications. The conference agreement provides a one-time financial institution group election that replaces and expands the bank group rules of present law (sec. 864(e)(5)(B)–(D)). At the election of the common parent of the affiliated group that has made the election to apply the worldwide affiliated group rules, those rules can be applied separately to a subgroup of the worldwide affiliated group that consists of all "financial corporations" that are part of the worldwide affiliated group.

For purposes of the financial institution group election, the conference agreement provides that a corporation is a financial corporation if at least 80 percent of its gross income is (1) "financial services income" (as described in section 904(d)(2)(C)(ii) and the regulations thereunder),[71] that is derived from transactions with unrelated persons or (2) dividends or financial services income derived directly or indirectly from related corporations that satisfy the 80-percent test by deriving financial services income from transactions with unrelated persons.[72] For this purpose, the conferees intend that certain ordering rules and netting rules with respect to amounts paid or accrued to and amounts received or accrued from related persons, similar to those provided in Treas. Reg. sec. 1.904–5(k), will apply. The conferees also intend that, for this purpose, gross income will not include gain from the disposition of the stock of a corporation that is related to the transferor prior to such disposition.[73] In addition, the conference agreement provides an anti-abuse rule under which items of income or gain from a transaction a principal purpose of which is to qualify a corporation as a financial corporation under these rules are disregarded.

Under the conference agreement, the financial institution group rules, if elected, apply to all members of the worldwide affiliated group that are financial corporations within the meaning of the provision. If a financial institution group election has been made, a member of the worldwide affiliated group that is part of the financial institution group cannot also be a member of a separate subsidiary group. The election must be made for the first taxable year beginning after December 31, 2001, in which a worldwide affiliated group includes a corporation that qualifies as a financial corporation. Once made, the election applies to the financial institution group for the taxable year and all subsequent taxable years. Therefore, if a financial institution group election is in place, a corporation that qualifies as a financial corporation for a taxable year will be included in the financial institution group for that year not-

[71] See Treas. Reg. sec. 1.904–4(e)(2).

[72] As is the case under the House bill, the conference agreement provides that certain bank holding companies that would qualify as part of the present-law bank group are also considered to be financial corporations.

[73] See Treas. Reg. sec. 1.904–4(e)(3)(i).

withstanding that it may not have qualified in prior years for which the election was in place. Similarly, a corporation that was a financial corporation in the first year in which an election was made will be included in the financial institution group for all subsequent years, but only to the extent that such corporation qualifies as a financial corporation for a given year. In addition, the conference agreement provides anti-abuse rules similar to those that apply in connection with the subsidiary group election.

Regulatory authority

The conference agreement follows the House bill and the Senate amendment in granting the Treasury Secretary authority to prescribe rules to carry out the purposes of the provision. Such authority includes, among other things, the authority to provide for direct allocation of interest expense in appropriate circumstances. The conferees intend that this authority to provide for direct allocation of interest expense includes, for example, circumstances in which interest expense is incurred by foreign corporations in order to circumvent the purposes of the provision.

Effective date

The provision in the conference agreement is effective for taxable years beginning after December 31, 2001.

B. Look-Through Rules to Apply to Dividends from Noncontrolled Section 902 Corporations (sec. 902 of the House bill, sec. 902 of the Senate amendment, and sec. 904 of the Code)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that may be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate limitations are applied to specific categories of income.

Special foreign tax credit limitations apply in the case of dividends received from a foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote and which is not a controlled foreign corporation (a so-called "10/50 company").[74] Dividends paid by a 10/50 company in taxable years beginning before January 1, 2003, are subject to a separate foreign tax credit limitation for each 10/50 company. Dividends paid by a 10/50 company that is not a passive foreign investment company in taxable years beginning after December 31, 2002, out of earnings and profits accumulated in taxable years beginning before January 1, 2003, are subject to a single foreign tax credit limitation for all 10/50 companies (other than passive foreign investment companies). Dividends paid by a 10/50 company that is a passive foreign investment company out of earnings and profits accumulated in taxable years beginning before January 1, 2003, continue to be subject to a sepa-

[74] A controlled foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote is treated as a 10/50 company with respect to any distribution out of earnings and profits for periods when it was not a controlled foreign corporation.

rate foreign tax credit limitation for each such 10/50 company. Dividends paid by a 10/50 company in taxable years beginning after December 31, 2002, out of earnings and profits accumulated in taxable years after December 31, 2002, are treated as income in a foreign tax credit limitation category in proportion to the ratio of the earnings and profits attributable to income in such foreign tax credit limitation category to the total earnings and profits (a so-called "look-through" approach). For these purposes, distributions are treated as made from the most recently accumulated earnings and profits. Regulatory authority is granted to provide rules regarding the treatment of distributions out of earnings and profits for periods prior to the taxpayer's acquisition of such stock.

House Bill

The House bill simplifies the application of the foreign tax credit limitation by applying the look-through approach to all dividends paid by a 10/50 company, regardless of the year in which the earnings and profits out of which the dividend is paid were accumulated. The House bill eliminates the single-basket limitation approach for dividends from such companies for foreign tax credit limitation purposes.

The House bill provides a transition rule under which pre-effective date foreign tax credits associated with a 10/50 company separate limitation category can be carried forward into post-effective date years. Under the House bill, look-through principles similar to those applicable to post-effective date dividends from a 10/50 company apply to determine the appropriate foreign tax credit limitation category or categories with respect to the foreign tax credit carryforward.

The House bill also provides a default rule in cases in which taxpayers are unable to obtain the necessary information to apply the look-through rules with respect to dividends from a 10/50 company (or in which the income is not treated as falling within one of certain enumerated limitation categories). In such cases, the House bill treats the dividend (or a portion thereof) from such 10/50 company as a dividend that is not subject to the look-through rules.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

Senate Amendment

The Senate amendment is the same as the House bill, with a modification to the effective date.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

Conference Agreement

The conference agreement follows the House bill.

C. Subpart F Treatment of Pipeline Transportation Income and Income from Transmission of High Voltage Electricity (secs. 903–904 of the House bill, secs. 903–904 of the Senate amendment, and sec. 954 of the Code)

Present Law

Under the subpart F rules, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are subject to U.S. tax currently on their shares of certain income earned by the foreign corporation, whether or not such income is distributed to the shareholders (referred to as "subpart F income"). Subpart F income includes foreign base company income, which in turn includes five categories of income: foreign personal holding company income, foreign base company sales income, foreign base company services income, foreign base company shipping income, and foreign base company oil related income (sec. 954(a)).

Foreign base company services income includes income from services performed (1) for or on behalf of a related party and (2) outside the country of the CFC's incorporation (sec. 954(e)). Treasury regulations provide that the services of the foreign corporation will be treated as performed for or on behalf of the related party if, for example, a party related to the foreign corporation furnishes substantial assistance to the foreign corporation in connection with the provision of services (Treas. Reg. sec. 1.954–4(b)(1)(iv)).

Foreign base company oil related income is income derived outside the United States from the processing of minerals extracted from oil or gas wells into their primary products; the transportation, distribution, or sale of such minerals or primary products; the disposition of assets used by the taxpayer in a trade or business involving the foregoing; or the performance of any related services. However, foreign base company oil related income does not include income derived from a source within a foreign country in connection with: (1) oil or gas which was extracted from a well located in such foreign country or, (2), oil, gas, or a primary product of oil or gas which is sold by the CFC or a related person for use or consumption within such foreign country or is loaded in such country as fuel on a vessel or aircraft. An exclusion also is provided for income of a CFC that is a small producer (i.e., a corporation whose average daily oil and natural gas production, including production by related corporations, is less than 1,000 barrels).

House Bill

The House bill exempts income derived in connection with the performance of services which are directly related to the transmission of high voltage electricity from the definition of foreign base company services income. Thus, the income of a CFC that owns a high voltage transmission line for the purpose of providing electricity generated by a related party to a third party outside the CFC's country of incorporation does not constitute foreign base company services income. No inference is intended as to the treatment of such income under present law.

The House bill also provides an additional exception to the definition of foreign base company oil related income. Under the

House bill, foreign base company oil related income does not include income derived from a source within a foreign country in connection with the pipeline transportation of oil or gas within such foreign country. Thus, the exception applies whether or not the CFC that owns the pipeline also owns any interest in the oil or gas transported. In addition, the exception applies to income earned from the transportation of oil or gas by pipeline in a country in which the oil or gas was neither extracted nor consumed.

Effective date.—The provision is effective for taxable years of CFCs beginning after December 31, 2001, and taxable years of U.S. shareholders with or within which such taxable years of CFCs end.

Senate Amendment

The Senate amendment is the same as the House bill, with a modification to the effective date.

Effective date.—The provision is effective for taxable years of CFCs beginning after December 31, 2002, and taxable years of U.S. shareholders with or within which such taxable years of CFCs end.

Conference Agreement

The conference agreement follows the House bill.

D. Recharacterization of Overall Domestic Loss (sec. 905 of the House bill and sec. 904 of the Code)

Present Law

A premise of the foreign tax credit is that it should not reduce a taxpayer's U.S. tax on its U.S.-source income; rather, it should only reduce U.S. tax on foreign-source income. An overall foreign tax credit limitation prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. The overall limitation is calculated by prorating a taxpayer's pre-credit U.S. tax on its worldwide income between its U.S.-source and foreign-source taxable income. The ratio (not exceeding 100 percent) of the taxpayer's foreign-source taxable income to worldwide taxable income is multiplied by its pre-credit U.S. tax to establish the amount of U.S. tax allocable to the taxpayer's foreign-source income and, thus, the upper limit on the foreign tax credit for the year. If the taxpayer's foreign-source taxable income exceeds worldwide taxable income (because of a domestic source loss), then the full amount of pre-credit U.S. tax may be offset by the foreign tax credit.

If a taxpayer's losses from foreign sources exceed its foreign-source income, the excess ("overall foreign loss" or "OFL") may offset U.S.-source income. Such an offset reduces the effective rate of U.S. tax on U.S.-source income. To eliminate a double benefit (that is, the reduction of U.S. tax previously noted and, later, full allowance of a foreign tax credit with respect to foreign-source income), an OFL recapture rule applies. Under this rule, a portion of foreign-source taxable income earned after an OFL year is recharacterized as U.S.-source taxable income for foreign tax credit purposes (and for purposes of the possessions tax credit) (sec. 904(f)(1)). Foreign-source taxable income up to the amount of the unrecaptured OFL may be so treated. In general, no more than 50

percent of the foreign-source taxable income earned in any particular taxable year is recharacterized as U.S.-source taxable income, unless a taxpayer elects a higher percentage.[75] The effect of the recapture is to reduce the foreign tax credit limitation in one or more years following an OFL year and, therefore, the amount of U.S. tax that can be offset by foreign tax credits in the later year or years.

An overall U.S.-source loss reduces pre-credit U.S. tax on worldwide income to an amount less than the hypothetical tax that would apply to the taxpayer's foreign-source income if viewed in isolation. The existence of foreign-source taxable income in the year of the U.S. loss reduces or eliminates any net operating loss carryover that the U.S. loss would otherwise have generated absent the foreign income. In addition, as the pre-credit U.S. tax on worldwide income is reduced, so is the foreign tax credit limitation. As a result, some foreign tax credits in the year of the U.S. loss must be credited, if at all, in a carryover year. Tax on domestic-source taxable income in a subsequent year may be offset by a net operating loss carryforward (if any), but not by a foreign tax credit carryforward. There is presently no mechanism for resourcing such subsequent U.S.-source income as foreign-source income.

House Bill

The House bill applies a resourcing rule to U.S.-source income where the taxpayer has suffered a reduction in the amount of its foreign tax credit limitation due to a prior overall domestic loss. Under the House bill, in the case of a taxpayer that has incurred an overall domestic loss, the portion of the taxpayer's U.S.-source taxable income for each succeeding taxable year that is equal to the lesser of (1) the amount of the unrecharacterized overall domestic loss, or (2) 50 percent of the taxpayer's U.S.-source taxable income for such succeeding taxable year is recharacterized as foreign-source taxable income.

The House bill defines an overall domestic loss for this purpose as any domestic loss to the extent it offsets foreign-source taxable income for the current taxable year or for any preceding taxable year by reason of a loss carryback. For this purpose, a domestic loss means the amount by which the U.S.-source gross income for the taxable year is exceeded by the sum of the deductions properly apportioned or allocated thereto, determined without regard to any loss carried back from a subsequent taxable year. Under the House bill, an overall domestic loss does not include any loss for any taxable year unless the taxpayer elected the use of the foreign tax credit for such taxable year.

Any U.S.-source income resourced under the House bill is allocated among the various foreign tax credit separate limitation categories in the same proportion that those categories were reduced by the prior overall domestic loss. In addition, the House bill grants

[75] If a taxpayer with an OFL disposes of property that was used predominantly outside the United States in a trade or business, the taxpayer generally is deemed to have received and recognized foreign-source taxable income as the result of a disposition in an amount at least equal to the lesser of the gain actually realized on the disposition or the remaining amount of the unrecaptured OFL. Furthermore, the annual 50-percent limit on the resourcing of foreign-source income does not apply to that amount of foreign-source income realized by reason of the disposition.

the Treasury Secretary authority to prescribe regulations as may be necessary to coordinate the operation of the OFL recapture rules with the operation of the overall domestic loss recharacterization rules that would be added by the House bill.

Effective date.—The provision applies to losses incurred in taxable years beginning after December 31, 2004.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to the effective date.

Effective date.—The provision applies to losses incurred in taxable years beginning after December 31, 2005.

E. Treatment of Military Property of Foreign Sales Corporations (sec. 906 of the House bill, sec. 908 of the Senate amendment, and sec. 923 of the Code)

Present Law

A portion of the foreign trade income of an eligible foreign sales corporation ("FSC") is exempt from federal income tax. Foreign trade income is defined as the gross income of a FSC that is attributable to foreign trading gross receipts. In general, the term "foreign trading gross receipts" means the gross receipts of a FSC from the sale or lease of export property, services related and subsidiary to the sale or lease of export property, engineering or architectural services for construction projects located outside the United States, and certain managerial services for an unrelated FSC or DISC.

Section 923(a)(5) contains a special limitation relating to the export of military property. Under regulations prescribed by the Treasury Secretary, the portion of a FSC's foreign trading gross receipts from the disposition of, or services relating to, military property that may be treated as exempt foreign trade income is limited to 50 percent of the amount that would otherwise be so treated. For this purpose, the term "military property" means any property that is an arm, ammunition, or implement of war designated in the munitions list published pursuant to federal law. Under this provision, the export of military property through a FSC is accorded one-half the tax benefit that is accorded to exports of non-military property.

House Bill

The House bill repeals the special FSC limitation relating to the export of military property, thus providing exports of military property through a FSC with the same treatment currently provided exports of non-military property.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

Senate Amendment

The Senate amendment is the same as the House bill, with a modification to the effective date.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

Conference Agreement

The conference agreement follows the House bill.

F. Modify Treatment of RIC Dividends Paid to Foreign Persons (sec. 907 of the House bill and secs. 871, 881, 897, 1441, 1442, and 2105 of the Code)

Present Law

Regulated investment companies

A regulated investment company ("RIC") is a domestic corporation that, at all times during the taxable year, is registered under the Investment Company Act of 1940 as a management company or as a unit investment trust, or has elected to be treated as a business development company under that Act (sec. 851(a)). In addition, to qualify as a RIC, a corporation must elect such status and must satisfy certain tests (sec. 851(b)). Generally, a RIC pays no income tax because it is permitted to deduct dividends paid to its shareholders in computing its taxable income.

A RIC generally may pass through to its shareholders the character of its long-term capital gains. It does this by designating a dividend it pays as a capital gain dividend to the extent that the RIC has net capital gain (i.e., net long-term capital gain over net short-term capital loss). These capital gain dividends are treated as long-term capital gains by the shareholders. A RIC generally also can pass through to its shareholders the character of tax-exempt interest from State and municipal bonds, but only if, at the close of each quarter of its taxable year, at least 50 percent of the value of the total assets of the RIC consists of these obligations. In this case, the RIC generally may designate a dividend it pays as an exempt-interest dividend to the extent that the RIC has tax-exempt interest income. These exempt-interest dividends are treated as interest excludable from gross income by the shareholders.

U.S. source investment income of foreign persons

The United States generally imposes a flat 30-percent tax, collected by withholding, on the gross amount of U.S.-source investment income payments, such as interest, dividends, rents, royalties, or similar types of income, to nonresident alien individuals and foreign corporations ("foreign persons") (secs. 871(a), 881, 1441, and 1442). Under treaties, the United States may reduce or eliminate such taxes. Even taking into account U.S. treaties, however, the tax on a dividend generally is not entirely eliminated. Instead, U.S.-source portfolio investment dividends received by foreign persons generally are subject to U.S. withholding tax at a rate of at least 15 percent.

Although payments of U.S.-source interest that is not effectively connected with a U.S. trade or business generally are subject to the 30-percent withholding tax, there are significant exceptions to that rule under which the U.S.-source interest payments to foreign persons are exempt from U.S. tax.

In addition, foreign persons generally are not subject to U.S. tax on gain realized on the disposition of stock or securities issued by a U.S. person, unless the gain is effectively connected with the conduct of a trade or business in the United States. Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), as amended, gain or loss of a foreign person from the disposition of a U.S. real property interest is subject to net basis tax as if the taxpayer were engaged in a trade or business within the United States and the gain or loss were effectively connected with such trade or business (sec. 897). Under the FIRPTA provisions, a distribution by a real estate investment trust ("REIT") to a foreign person generally is, to the extent attributable to gain from sales or exchanges by the REIT of U.S. real property interests, treated as gain recognized by the foreign person from the sale or exchange of a U.S. real property interest (sec. 897(h)). In view of the nature of a REIT, an interest in a REIT may in some cases be considered to be a U.S. real property interest.

Estate taxation

Decedents who were citizens or residents of the United States are generally subject to Federal estate tax on all property, wherever situated. Nonresidents who are not U.S. citizens, however, are subject to estate tax only on their property which is within the United States. Property within the United States generally includes debt obligations of U.S. persons, including the Federal government and State and local governments (sec. 2104(c)), but does not include either bank deposits or portfolio obligations, the interest on which would be exempt from U.S. income tax under section 871 (sec. 2105(b)).

House Bill

Under the House bill, a RIC that earns certain net interest income that would not be subject to U.S. tax if earned by a foreign person directly may, to the extent of such income, designate a dividend it pays as derived from such net interest income. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, just as if the foreign person had earned the interest directly. Similarly, a RIC that earns an excess of net short-term capital gains over net long-term capital losses, which excess would not be subject to U.S. tax if earned by a foreign person directly, generally may, to the extent of such excess, designate a dividend it pays as derived from such excess. A foreign person who is a shareholder in the RIC generally would treat such a dividend as exempt from gross-basis U.S. tax, just as if the foreign person had realized the amount directly.

As is true under present law for distributions from REITs, the House bill provides that any distribution by a RIC to a foreign person shall, to the extent attributable to gain from the sale or exchange by the RIC of an asset that is considered a U.S. real prop-

erty interest, be treated as gain recognized by the foreign person from the sale or exchange of a U.S. real property interest. The House bill also extends the special rules for domestically-controlled REITS to domestically-controlled RICs.

The House bill provides that the estate of a foreign decedent is exempt from U.S. estate tax on a transfer of stock in the RIC in the proportion that the assets held by the RIC are debt obligations, deposits, or other property that would generally be treated as situated outside the United States if held directly by the estate.

Effective date.—The House bill generally applies to dividends with respect to taxable years of RICs beginning after December 31, 2004. With respect to the treatment of a RIC for estate tax purposes, the House bill applies to estates of decedents dying after December 31, 2004. With respect to the treatment of RICs under section 897 (dealing with U.S. real property interests), the House bill is effective on January 1, 2005.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

G. Repeal of Special Rules for Applying Foreign Tax Credit in Case of Foreign Oil and Gas Income (sec. 908 of the House bill and sec. 907 of the Code)

Present Law

U.S. persons are subject to U.S. income tax on their worldwide income. A credit against U.S. tax on foreign-source income is allowed for foreign taxes paid or accrued (or deemed paid) (secs. 901, 902).

The amount of foreign tax credits that a taxpayer may claim in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income (sec. 904). The foreign tax credit limitation is calculated on an overall basis and separately for specific categories of income. The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year that exceeds the respective foreign tax credit limitations is permitted to be carried back two years and carried forward five years (sec. 904(c)).

Special rules apply with respect to the foreign tax credit in the case of foreign oil and gas income (sec. 907). Under a special limitation, taxes on foreign oil and gas extraction income are creditable only to the extent that they do not exceed a specified amount (e.g., 35 percent of such income in the case of a corporation) (sec. 907(a)). For this purpose, foreign oil and gas extraction income is income derived from foreign sources from the extraction of minerals from oil or gas wells or the sale or exchange of assets used by the taxpayer in such extraction. A taxpayer must have excess limitation under the special rules applicable to foreign extraction taxes and excess limitation under the general foreign tax credit provisions in order to utilize excess foreign oil and gas extraction taxes in a

carryback or carryforward year. In addition, in the case of taxes paid or accrued to any foreign country with respect to certain foreign oil related income, discriminatory foreign taxes are not treated as creditable foreign taxes (sec. 907(b)).

House Bill

The House bill repeals the special rules of section 907 for applying the foreign tax credit in the case of foreign oil and gas income.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification to the effective date.

Effective date.—The provision is effective for taxable years beginning after December 31, 2007.

H. Study of Proper Treatment of European Union under Subpart F Same Country Exceptions (sec. 909 of the House bill)

Present Law

In general, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are required to include in income for U.S. tax purposes currently certain income of the CFC (referred to as "subpart F income"), without regard to whether the income is distributed to the shareholders (sec. 951(a)(1)(A)). In effect, the Code treats the U.S. 10-percent shareholders of a CFC as having received a current distribution of their pro rata shares of the CFC's subpart F income. For this purpose, a U.S. 10-percent shareholder is a U.S. person that owns 10 percent or more of the corporation's stock (measured by vote) (sec. 951(b)). In general, a foreign corporation is a CFC if U.S. 10-percent shareholders own more than 50 percent of such corporation's stock (measured by vote or by value) (sec. 957).

Subpart F income typically is passive income or income that is relatively movable from one taxing jurisdiction to another. Subpart F income consists of foreign base company income (defined in sec. 954), insurance income (defined in sec. 953), and certain income relating to international boycotts and other violations of public policy (defined in sec. 952(a)(3)–(5)). Subpart F income does not include income of the CFC that is effectively connected with the conduct of a trade or business within the United States (on which income the CFC is subject to current U.S. tax) (sec. 952(b)).

Income of a CFC may be excepted from the subpart F provisions under various same country exceptions. For example, a major category of foreign base company income is foreign personal holding company income, which generally includes, among other things, certain dividends, interest, rents and royalties (sec. 954(c)). Same

country exceptions from treatment as subpart F foreign personal holding company income generally are provided for dividends and interest received by the CFC from a related person that (1) is a corporation organized under the laws of the same foreign country in which the CFC is created or organized and (2) has a substantial part of its assets used in a trade or business located in such same foreign country. Similarly, same country exceptions from subpart F foreign personal holding income generally are provided for rents and royalties received by the CFC from a related corporation for the use of property within the country in which the CFC is created or organized (sec. 954(c)(3)).

House Bill

The House bill directs the Treasury Secretary to conduct a study of the feasibility of treating all countries included in the European Union as one country for purposes of applying same country exceptions under subpart F. The House bill requires the results of the study to be reported to the House Committee on Ways and Means and the Senate Committee on Finance, along with any legislative recommendations, no later than 6 months after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the provision in the House bill. The conferees, however, encourage the Treasury Department to study the feasibility of treating all countries included in the European Union as one country for purposes of applying same country exceptions under subpart F.

I. Provide Waiver from Denial of Foreign Tax Credits (sec. 910 of the House bill and sec. 901(j) of the Code)

Present Law

In general, U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate limitations are applied to specific categories of income.

Pursuant to special rules applicable to taxes paid to certain foreign countries, no foreign tax credit is allowed for income, war profits, or excess profit taxes paid, accrued, or deemed paid to a country which satisfies specified criteria, to the extent that the taxes are with respect to income attributable to a period during which such criteria were satisfied (sec. 901(j)). Section 901(j) applies with respect to any foreign country: (1) the government of which the United States does not recognize, unless such government is otherwise eligible to purchase defense articles or services under the Arms Export Control Act, (2) with respect to which the United States has severed diplomatic relations, (3) with respect to

which the United States has not severed diplomatic relations but does not conduct such relations, or (4) which the Secretary of State has, pursuant to section 6(j) of the Export Administration Act of 1979, as amended, designated as a foreign country which repeatedly provides support for acts of international terrorisms (a "section 901(j) foreign country"). The denial of credits applies to any foreign country during the period beginning on the later of January 1, 1987, or six months after such country becomes a section 901(j) country, and ending on the date the Secretary of State certifies to the Secretary of the Treasury that such country is no longer a section 901(j) country.

Taxes treated as noncreditable under section 901(j) generally are permitted to be deducted notwithstanding the fact that the taxpayer elects use of the foreign tax credit for the taxable year with respect to other taxes. In addition, income for which foreign tax credits are denied generally cannot be sheltered from U.S. tax by other creditable foreign taxes.

Under the rules of subpart F, U.S. 10-percent shareholders of a controlled foreign corporation ("CFC") are required to include in income currently certain types of income of the CFC, whether or not such income is actually distributed currently to the shareholders (referred to as "subpart F income"). Subpart F income includes income derived from any foreign country during a period in which the taxes imposed by that country are denied eligibility for the foreign tax credit under section 901(j) (sec. 952(a)(5)).

House Bill

The House bill provides that section 901(j) no longer applies with respect to a foreign country if the President determines that the application of section 901(j) to such foreign country is not in the national interests of the United States.

Effective date.—The provision is effective as of the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the provision in the House bill.

J. Prohibit Disclosure of APAs and APA Background Files (sec. 911 of the House bill, sec. 905 of the Senate amendment and secs. 6103 and 6110 of the Code)

Present Law

Section 6103

Under section 6103, returns and return information are confidential and cannot be disclosed unless authorized by the Internal Revenue Code.

The Code defines return information broadly. Return information includes:

A taxpayer's identity, the nature, source or amount of income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments;

Whether the taxpayer's return was, is being, or will be examined or subject to other investigation or processing; or

Any other data, received by, recorded by, prepared by, furnished to, or collected by the Secretary with respect to a return or with respect to the determination of the existence, or possible existence, of liability (or the amount thereof) of any person under this title for any tax, penalty, interest, fine, forfeiture, or other imposition, or offense.[76]

Section 6110 and the Freedom of Information Act

With certain exceptions, section 6110 makes the text of any written determination the IRS issues available for public inspection. A written determination is any ruling, determination letter, technical advice memorandum, or Chief Counsel advice. Once the IRS makes the written determination publicly available, the background file documents associated with such written determination are available for public inspection upon written request. The Code defines "background file documents" as any written material submitted in support of the request. Background file documents also include any communications between the IRS and persons outside the IRS concerning such written determination that occur before the IRS issues the determination.

Before making them available for public inspection, section 6110 requires the IRS to delete specific categories of sensitive information from the written determination and background file documents.[77] It also provides judicial and administrative procedures to resolve disputes over the scope of the information the IRS will disclose. In addition, Congress has also wholly exempted certain matters from section 6110's public disclosure requirements.[78] Any part of a written determination or background file that is not disclosed under section 6110 constitutes "return information."[79]

The Freedom of Information Act (FOIA) lists categories of information that a federal agency must make available for public inspection.[80] It establishes a presumption that agency records are accessible to the public. The FOIA, however, also provides nine exemptions from public disclosure. One of those exemptions is for

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[76] Sec. 6103(b)(2)(A).

[77] Sec. 6110(c) provides for the deletion of identifying information, trade secrets, confidential commercial and financial information and other material.

[78] Sec. 6110(l).

[79] Sec. 6103(b)(2)(B) ("The term 'return information' means . . . any part of any written determination or any background file document relating to such written determination (as such terms are defined in section 6110(b)) which is not open to public inspection under section 6110").

[80] Unless published promptly and offered for sale, an agency must provide for public inspection and copying: (1) final opinions as well as orders made in the adjudication of cases; (2) statements of policy and interpretations not published in the Federal Register; (3) administrative staff manuals and instructions to staff that affect a member of the public; and (4) agency records which have been or the agency expects to be, the subject of repetitive FOIA requests. 5 U.S.C. sec. 552(a)(2). An agency must also publish in the Federal Register: the organizational structure of the agency and procedures for obtaining information under the FOIA; statements describing the functions of the agency and all formal and informal procedures; rules of procedure, descriptions of forms and statements describing all papers, reports and examinations; rules of general applicability and statements of general policy; and amendments, revisions and repeals of the foregoing. 5 U.S.C. sec. 552(a)(1). All other agency records can be sought by FOIA request; however, some records may be exempt from disclosure.

matters specifically exempted from disclosure by a statute other than the FOIA if the exempting statute meets certain requirements.[81] Section 6103 qualifies as an exempting statute under this FOIA provision. Thus, returns and return information that section 6103 deems confidential are exempt from disclosure under the FOIA.

Section 6110 is the exclusive means for the public to view IRS written determinations.[82] If section 6110 covers the written determination, then the public cannot use the FOIA to obtain that determination.

Advance Pricing Agreements

The Advanced Pricing Agreement ("APA") program is an alternative dispute resolution program conducted by the IRS, which resolves international transfer pricing issues prior to the filing of the corporate tax return. Specifically, an APA is an advance agreement establishing an approved transfer pricing methodology entered into among the taxpayer, the IRS, and a foreign tax authority. The IRS and the foreign tax authority generally agree to accept the results of such approved methodology. Alternatively, an APA also may be negotiated between just the taxpayer and the IRS; such an APA establishes an approved transfer pricing methodology for U.S. tax purposes. The APA program focuses on identifying the appropriate transfer pricing methodology; it does not determine a taxpayer's tax liability. Taxpayers voluntarily participate in the program.

To resolve the transfer pricing issues, the taxpayer submits detailed and confidential financial information, business plans and projections to the IRS for consideration. Resolution involves an extensive analysis of the taxpayer's functions and risks. Since its inception in 1991, the APA program has resolved more than 180 APAs, and approximately 195 APA requests are pending.

Currently pending in the U.S. District Court for the District of Columbia are three consolidated lawsuits asserting that APAs are subject to public disclosure under either section 6110 or the FOIA.[83] Prior to this litigation and since the inception of the APA program, the IRS held the position that APAs were confidential return information protected from disclosure by section 6103.[84] On January 11, 1999, the IRS conceded that APAs are "rulings" and therefore are "written determinations" for purposes of section 6110.[85] Although the court has not yet issued a ruling in the case, the IRS announced its plan to publicly release both existing and fu-

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[81] Exemption 3 of the FOIA provides that an agency is not required to disclose matters that are: "(3) specifically exempted from disclosure by statute (other than section 552b of this title) provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular criteria for withholding or refers to particular types of matters to be withheld; . . ." 5 U.S.C. § 552(b)(3).

[82] Sec. 6110(m).

[83] *BNA* v. *IRS,* Nos. 96–376, 96–2820, and 96–1473 (D.D.C.). The Bureau of National Affairs, Inc. (BNA) publishes matters of interest for use by its subscribers. BNA contends that APAs are not return information as they are prospective in application. Thus at the time they are entered into they do not relate to "the determination of the existence, or possible existence, of liability or amount thereof . . ."

[84] The IRS contended that information received or generated as part of the APA process pertains to a taxpayer's liability and therefore was return information as defined in sec. 6103(b)(2)(A). Thus, the information was subject to section 6103's restrictions on the dissemination of returns and return information. Rev. Proc. 91–22, sec. 11, 1991–1 C.B. 526, 534 and Rev. Proc. 96–53, sec. 12, 1996–2 C.B. 375, 386.

[85] IR 1999–05.

ture APAs. The IRS then transmitted existing APAs to the respective taxpayers with proposed deletions. It has received comments from some of the affected taxpayers. Where appropriate, foreign tax authorities have also received copies of the relevant APAs for comment on the proposed deletions. No APAs have yet been released to the public.

Some taxpayers assert that the IRS erred in adopting the position that APAs are subject to section 6110 public disclosure. Several have sought to participate as *amici* in the lawsuit to block the release of APAs. They are concerned that release under section 6110 could expose them to expensive litigation to defend the deletion of the confidential information from their APAs. They are also concerned that the section 6110 procedures are insufficient to protect the confidentiality of their trade secrets and other financial and commercial information.

House Bill

The House bill amends section 6103 to provide that APAs and related background information are confidential return information under section 6103. Related background information is meant to include: the request for an APA, any material submitted in support of the request, and any communication (written or otherwise) prepared or received by the Secretary in connection with an APA, regardless of when such communication is prepared or received. Protection is not limited to agreements actually executed; it includes material received and generated in the APA process that does not result in an executed agreement.

Further, APAs and related background information are not "written determinations" as that term is defined in section 6110. Therefore, the public inspection requirements of section 6110 do not apply to APAs and related background information. A document's incorporation in a background file, however, is not intended to be grounds for not disclosing an otherwise disclosable document from a source other than a background file.

The House bill statutorily requires that the Treasury Department prepare and publish an annual report on the status of APAs. The annual report is to contain the following information:

Information about the structure, composition, and operation of the APA program office;

A copy of each current model APA;

Statistics regarding the amount of time to complete new and renewal APAs;

The number of APA applications filed during such year;

The number of APAs executed to date and for the year;

The number of APA renewals issued to date and for the year;

The number of pending APA requests;

The number of pending APA renewals;

The number of APAs executed and pending (including renewals and renewal requests) that are unilateral, bilateral and multilateral, respectively;

The number of APAs revoked or canceled, and the number of withdrawals from the APA program, to date and for the year;

The number of finalized new APAs and renewals by industry;[86] and

General descriptions of:

the nature of the relationships between the related organizations, trades, or businesses covered by APAs;

the related organizations, trades, or businesses whose prices or results are tested to determine compliance with the transfer pricing methodology prescribed in the APA;

the covered transactions and the functions performed and risks assumed by the related organizations, trades or businesses involved;

methodologies used to evaluate tested parties and transactions and the circumstances leading to the use of those methodologies;

critical assumptions;

sources of comparables;

comparable selection criteria and the rationale used in determining such criteria;

the nature of adjustments to comparables and/or tested parties;

the nature of any range agreed to, including information such as whether no range was used and why, whether an inter-quartile range was used, or whether there was a statistical narrowing of the comparables;

adjustment mechanisms provided to rectify results that fall outside of the agreed upon APA range;

the various term lengths for APAs, including rollback years, and the number of APAs with each such term length;

the nature of documentation required; and

approaches for sharing of currency or other risks.

The first report is to cover the period January 1, 1991, through the calendar year including the date of enactment. The Treasury Department cannot include any information in the report which would have been deleted under section 6110(c) if the report were a written determination as defined in section 6110. Additionally, the report cannot include any information which can be associated with or otherwise identify, directly or indirectly, a particular taxpayer. The Secretary is expected to obtain input from taxpayers to ensure proper protection of taxpayer information and, if necessary, utilize its regulatory authority to implement appropriate processes for obtaining this input. For purposes of section 6103, the report requirement is treated as part of Title 26.

The IRS user fee otherwise required to be paid for an APA is increased by $500. The Secretary has the authority to make appropriate reductions in such fee for small businesses.

While the House bill statutorily requires an annual report, it is not intended to discourage the Treasury Department from issuing other forms of guidance, such as regulations or revenue rulings, consistent with the confidentiality provisions of the Code.

Effective date.—The provision is effective on the date of enactment; accordingly, no APAs, regardless of whether executed before

[86] This information was previously released in IRS Publication 3218, "IRS Report on Application and Administration of I.R.C. Section 482."

or after enactment, or related background file documents can be released to the public after the date of enactment. It requires the Treasury Department to publish the first annual report no later than March 30, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. In addition, the conference agreement requires the IRS to describe, in each annual report, its efforts to ensure compliance with existing APA agreements.

K. Increase Dollar Limitation on Section 911 Exclusion (sec. 912 of the House bill and sec. 911 of the Code)

Present Law

U.S. citizens generally are subject to U.S. income tax on their worldwide income. A U.S. citizen who earns income in a foreign country also may be taxed on such income by that foreign country. A credit against the U.S. income tax imposed on foreign-source income is allowed for foreign taxes paid on such income.

U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either (1) a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (2) present in a foreign country or countries for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

The exclusion for foreign earned income generally applies to income earned from sources outside the United States as compensation for personal services actually rendered by the taxpayer. The maximum exclusion for foreign earned income for taxable years before 1998 is $70,000. Beginning in 1998, the maximum exclusion is increased in increments of $2,000 per year until the exclusion amount is $80,000 (i.e., in the year 2002). The maximum exclusion is $74,000 for 1999. The exclusion is indexed for inflation beginning in 2008 (for inflation after 2006).

The exclusion for housing costs applies to reasonable expenses, other than deductible interest and taxes, paid or incurred by or on behalf of the taxpayer for housing for the taxpayer and his or her spouse and dependents in a foreign country. The exclusion amount for housing costs for a taxable year is equal to the excess of such housing costs for the taxable year over an amount computed pursuant to a specified formula.

The combined earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income. The taxpayer's foreign tax credit is reduced by the amount of the credit that is attributable to excluded income.

House Bill

The House bill increases the maximum exclusion for foreign earned income in annual increments of $3,000 per year beginning in 2003, until the exclusion amount is $95,000 (i.e., in the year 2007). Thus, for the years 2003 through 2007, the maximum exclusion gradually increases from $83,000 to $95,000. Beginning in 2008, the maximum exclusion amount of $95,000 is indexed for inflation.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

L. Exempt Certain Sales of Frequent-Flyer and Similar Reduced-Fare Air Transportation Rights from Aviation Excise Taxes (sec. 906 of the Senate amendment and sec. 4261 of the Code)

Present Law

A 7.5-percent excise tax is imposed on the sale by an air transportation provider of the right to frequent-flyer or similar reduced-fare air transportation. Like the aviation excise taxes imposed on the sale of actual air transportation, this tax is imposed on all amounts paid for the right to air transportation if the right can be used for transportation to, from, or within the United States. In both cases, tax is imposed without regard to whether the sale occurs within the United States or elsewhere. Further, subject to an exception for rights actually used for purposes other than air transportation (as determined under Treasury Department regulations), the tax is imposed without regard to whether the rights ultimately are used for travel (to, from, or within United States or between two or more points in foreign countries) or expire without use.

The current authority granted to the Treasury Department to exempt certain awards does not permit an exemption unless the rights actually are used for a purpose other than air transportation (e.g., hotels or car rentals). Thus, under present law, rights are taxable even if transportation for which they ultimately are used has no nexus to the United States.

House Bill

No provision.

Senate Amendment

The Senate amendment exempts from the 7.5-percent tax, air transportation rights sold which are credited to accounts of persons having a mailing address outside the United States. Mailing addresses are those listed on the records of the operator of the frequent-flyer or similar program.

Effective date.—The provision applies to air transportation rights sold after December 31, 2004.

Conference Agreement

The conference agreement follows the Senate amendment. As with the present-law regulatory exception for certain rights shown to be used for purposes other than air transportation, this statutory exemption is limited to amounts which are documented by the person providing the right to transportation (i.e., the operator of the frequent-flyer or similar program) as credited to accounts of persons having mailing addresses outside the United States.

X. TAX–EXEMPT ORGANIZATION PROVISIONS

A. Provide Tax Exemption for Organizations Created by a State to Provide Property and Casualty Insurance Coverage for Property for Which Such Coverage Is Otherwise Unavailable (sec. 1001 of the House bill, sec. 801 of the Senate amendment, and sec. 501(c)(28) of the Code)

Present Law

A life insurance company is subject to tax on its life insurance company taxable income, which is its life insurance income reduced by life insurance deductions (sec. 801). Similarly, a property and casualty insurance company is subject to tax on its taxable income, which is determined as the sum of its underwriting income and investment income (as well as gains and other income items) (sec. 831). Present law provides that the term "corporation" includes an insurance company (sec. 7701(a)(3)).

In general, the Internal Revenue Service ("IRS") takes the position that organizations that provide insurance for their members or other individuals are not considered to be engaged in a tax-exempt activity. The IRS maintains that such insurance activity is either (1) a regular business of a kind ordinarily carried on for profit, or (2) an economy or convenience in the conduct of members' businesses because it relieves the members from obtaining insurance on an individual basis.

Certain insurance risk pools have qualified for tax exemption under Code section 501(c)(6). In general, these organizations (1) assign any insurance policies and administrative functions to their member organizations (although they may reimburse their members for amounts paid and expenses); (2) serve an important common business interest of their members; and (3) must be membership organizations financed, at least in part, by membership dues.

State insurance risk pools may also qualify for tax exempt status under section 501(c)(4) as a social welfare organization or under section 115 as serving an essential governmental function of a State. In seeking qualification under section 501(c)(4), insurance organizations generally are constrained by the restrictions on the provision of "commercial-type insurance" contained in section 501(m). Section 115 generally provides that gross income does not include income derived from the exercise of any essential governmental function or accruing to a State or any political subdivision thereof.

Certain specific provisions provide tax-exempt status to organizations meeting statutory requirements.

Health coverage for high-risk individuals

Section 501(c)(26) provides tax-exempt status to any membership organization that is established by a State exclusively to provide coverage for medical care on a nonprofit basis to certain high-risk individuals, provided certain criteria are satisfied. The organization may provide coverage for medical care either by issuing insurance itself or by entering into an arrangement with a health maintenance organization ("HMO").

High-risk individuals eligible to receive medical care coverage from the organization must be residents of the State who, due to a pre-existing medical condition, are unable to obtain health coverage for such condition through insurance or an HMO, or are able to acquire such coverage only at a rate that is substantially higher than the rate charged for such coverage by the organization. The State must determine the composition of membership in the organization. For example, a State could mandate that all organizations that are subject to insurance regulation by the State must be members of the organization.

The provision further requires the State or members of the organization to fund the liabilities of the organization to the extent that premiums charged to eligible individuals are insufficient to cover such liabilities. Finally, no part of the net earnings of the organization can inure to the benefit of any private shareholder or individual.

Workers' compensation reinsurance organizations

Section 501(c)(27)(A) provides tax-exempt status to any membership organization that is established by a State before June 1, 1996, exclusively to reimburse its members for workers' compensation insurance losses, and that satisfies certain other conditions. A State must require that the membership of the organization consist of all persons who issue insurance covering workers' compensation losses in such State, and all persons and governmental entities who self-insure against such losses. In addition, the organization must operate as a nonprofit organization by returning surplus income to members or to workers' compensation policyholders on a periodic basis and by reducing initial premiums in anticipation of investment income.

State workmen's compensation act companies

Section 501(c)(27)(B) provides tax-exempt status for any organization that is created by State law, and organized and operated exclusively to provide workmen's compensation insurance and related coverage that is incidental to workmen's compensation insurance, and that meets certain additional requirements. The workmen's compensation insurance must be required by State law, or be insurance with respect to which State law provides significant disincentives if it is not purchased by an employer (such as loss of exclusive remedy or forfeiture of affirmative defenses such as contributory negligence). The organization must provide workmen's compensation to any employer in the State (for employees in the

State or temporarily assigned out-of-State) seeking such insurance and meeting other reasonable requirements. The State must either extend its full faith and credit to the initial debt of the organization or provide the initial operating capital of such organization. For this purpose, the initial operating capital can be provided by providing the proceeds of bonds issued by a State authority; the bonds may be repaid through exercise of the State's taxing authority, for example. For periods after the date of enactment, either the assets of the organization must revert to the State upon dissolution, or State law must not permit the dissolution of the organization absent an act of the State legislature. Should dissolution of the organization become permissible under applicable State law, then the requirement that the assets of the organization revert to the State upon dissolution applies. Finally, the majority of the board of directors (or comparable oversight body) of the organization must be appointed by an official of the executive branch of the State or by the State legislature, or by both.

House Bill

The provision provides tax-exempt status for any association created before January 1, 1999, by State law and organized and operated exclusively to provide property and casualty insurance coverage for property located within the State for which the State has determined that coverage in the authorized insurance market is limited or unavailable at reasonable rates, provided certain requirements are met.

Under the provision, no part of the net earnings of the association may inure to the benefit of any private shareholder or individual. Except as provided in the case of dissolution, no part of the assets of the association may be used for, or diverted to, any purpose other than: (1) to satisfy, in whole or in part, the liability of the association for, or with respect to, claims made on policies written by the association; (2) to invest in investments authorized by applicable law; (3) to pay reasonable and necessary administration expenses in connection with the establishment and operation of the association and the processing of claims against the association (4) to make remittances pursuant to State law to be used by the State to provide for the payment of claims on policies written by the association, purchase reinsurance covering losses under such policies, or to support governmental programs to prepare for or mitigate the effects of natural catastrophic events. The provision requires that the State law governing the association permit the association to levy assessments on insurance companies authorized to sell property and casualty insurance in the State, or on property and casualty insurance policyholders with insurable interests in property located in the State to fund deficits of the association, including the creation of reserves. The provision requires that the plan of operation of the association be subject to approval by the chief executive officer or other official of the State, by the State legislature, or both. In addition, the provision requires that the assets of the association revert upon dissolution to the State, the State's designee, or an entity designated by the State law governing the association, or that State law not permit the dissolution of the association.

The provision provides a special rule in the case of any entity or fund created before January 1, 1999, pursuant to State law and organized and operated exclusively to receive, hold, and invest remittances from an association exempt from tax under the provision, to make disbursements to pay claims on insurance contracts issued by the association, and to make disbursements to support governmental programs to prepare for or mitigate the effects of natural catastrophic events. The special rule provides that the entity or fund may elect to be disregarded as a separate entity and be treated as part of the association exempt from tax under the provision, from which it receives such remittances. The election is required to be made no later than 30 days following the date on which the association is determined to be exempt from tax under the provision, and would be effective as of the effective date of that determination.

An organization described in the provision is treated as having unrelated business taxable income ("UBIT") in the amount of its taxable income (computed as if the organization were not exempt from tax under the proposal), if at the end of the immediately preceding taxable year, the organization's net equity exceeded 15 percent of the total coverage in force under insurance contracts issued by the organization and outstanding at the end of that preceding year.

Under the provision, no income or gain is recognized solely as a result of the change in status to that of an association exempt from tax under the provision.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999. No inference is intended as to the tax status under present law of associations described in the provision.

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

B. Conform Provisions Relating to Arbitrage Treatment to Reflect Proposed State Constitutional Amendments (sec. 1002 of the House bill)

Present Law

In general, present-law tax-exempt bond arbitrage restrictions provide that interest on a State or local government bond is not eligible for tax-exemption if the proceeds are invested, directly or indirectly, in materially higher yielding investments or if the debt service on the bond is secured by or paid from (directly or indirectly) such investments. An exception, enacted in 1984, provides that the pledge of income from investments in a Fund established under a provision of a State constitution adopted in 1876 as security for a limited amount of tax-exempt bonds for two State university systems will not cause interest on those bonds to be taxable.

The terms of this exception are limited to State constitutional or statutory restrictions in effect as of October 9, 1969.

The General Assembly of the State has approved proposed constitutional amendments regarding the manner in which amounts in the Fund are paid for the benefit of the two university systems. These proposed amendments are to be voted on by the State's citizens in November 1999. If approved, the amendments will in substance eliminate the benefits of the 1984 exception from the tax-exempt bond arbitrage restrictions for future debt.

House Bill

The 1984 exception is conformed to the proposed State constitutional amendments to permit its continued applicability to bonds of the two university systems. Limitations on the aggregate amount of bonds which may benefit from the exception are not modified.

Effective date.—The provision applies to bonds issued after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

C. Authorize Secretary of Treasury to Grant Waivers from Section 4941 Prohibitions (sec. 1004 of the House bill and sec. 4941 of the Code)

Present Law

In order to prohibit transactions between tax-exempt private foundations and certain related persons, present law provides for the imposition of excise taxes when "disqualified persons" engage in acts of "self-dealing" with a private foundation (sec. 4941). Disqualified persons include foundation managers (directors, trustees, and officers of the foundation), substantial contributors to the foundation, certain family members of these persons, and certain entities related to these persons. Disqualified persons also include government officials at certain levels.

Acts of self-dealing include any direct or indirect: (1) sale, exchange, or leasing of property between a private foundation and a disqualified person, (2) lending of money or extensions of credit between a private foundation and a disqualified person, (3) furnishing of goods, services, or facilities between a private foundation and a disqualified person, (4) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person, (5) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, and (6) agreement by a private foundation to make any payment of money or other property to a government official.[87] There is no exception

[87] There are certain limited transactions between disqualified persons and private foundations that are defined by statute not to constitute acts of self-dealing.

from the prohibition on acts of self-dealing for inadvertent violations, and even transactions which arguably may benefit the private foundation may be subject to tax as an act of self-dealing.

Self-dealing excise taxes are imposed on a disqualified person who has engaged in a self-dealing transaction, and on any foundation manager who knowingly participates in the transaction. At the first level of tax, a disqualified person is subject to an initial tax at a rate of 5 percent and a foundation manager at a rate of 2.5 percent (up to a maximum of $10,000) of the "amount involved" in the act of self-dealing. Where the self-dealing transaction involves the use of money (e.g., a loan) or other property, the "amount involved" generally is the greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the property received. Section 4941 also imposes a second level of taxes at higher rates where an act of self-dealing has occurred and the transaction is not corrected within a specified period of time.

House Bill

The House bill requires the Secretary of the Treasury to establish an exemption procedure pursuant to which the Secretary can grant a conditional or unconditional exemption from the self-dealing prohibition of section 4941. The Secretary is permitted to grant an exemption for any disqualified person or transaction, or class of disqualified persons or transactions, if such exemption is: (1) administratively feasible, (2) in the interests of the private foundation, and (3) protective of the rights of the private foundation. The House bill requires that, prior to granting such an exemption, the Secretary must: (1) require that adequate notice be given to interested persons, (2) publish notice in the Federal Register of the pendency of a request for an exemption, and (3) afford interested persons an opportunity to present their views.

Effective date.—The House bill is effective for transactions occurring after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

D. Extend Declaratory Judgment Procedures to Non-501(c)(3) Tax-exempt Organizations (sec. 1005 of the House bill and sec. 7428 of the Code)

Present Law

In order for an organization to be granted tax exemption as a charitable entity described in section 501(c)(3), it generally must file an application for recognition of exemption with the IRS and receive a favorable determination of its status. Similarly, for most organizations, a charitable organization's eligibility to receive tax-deductible contributions is dependent upon its receipt of a favorable determination from the IRS. In general, a section 501(c)(3) or-

ganization can rely on a determination letter or ruling from the IRS regarding its tax-exempt status, unless there is a material change in its character, purposes, or methods of operation. In cases where an organization violates one or more of the requirements for tax exemption under section 501(c)(3), the IRS is authorized to revoke an organization's tax exemption, notwithstanding an earlier favorable determination.

In situations where the IRS denies an organization's application for recognition of exemption under section 501(c)(3) or fails to act on such application, or where the IRS informs a section 501(c)(3) organization that it is considering revoking or adversely modifying its tax-exempt status, present law authorizes the organization to seek a declaratory judgment regarding its tax status (sec. 7428). Section 7428 provides a remedy in the case of a dispute involving a determination by the IRS with respect to: (1) the initial qualification or continuing qualification of an organization as a charitable organization for tax exemption purposes or for charitable contribution deduction purposes; (2) the initial classification or continuing classification of an organization as a private foundation; (3) the initial classification or continuing classification of an organization as a private operating foundation; or (4) the failure of the IRS to make a determination with respect to (1), (2), or (3). A "determination" in this context generally means a final decision by the IRS affecting the tax qualification of a charitable organization, although it also can include a proposed revocation of an organization's tax-exempt status or public charity classification. Section 7428 vests jurisdiction over controversies involving such a determination in the U.S. District Court for the District of Columbia, the U.S. Court of Federal Claims, and the U.S. Tax Court.

Prior to utilizing the declaratory judgment procedure, an organization must have exhausted all administrative remedies available to it within the IRS. For the first 270 days after a request for a determination is made, an organization is deemed to not have exhausted its administrative remedies. Provided that no determination is made during the 270-day period, the organization may initiate an action for declaratory judgment after the period has elapsed. If, however, the IRS makes an adverse determination during the 270-day period, an organization may initiate a declaratory judgment immediately. The 270-day period does not begin with respect to applications for recognition of tax-exempt status until the date a substantially completed application is submitted.

In contrast to the rules governing charities, it is a disputed issue as to whether non-charities (i.e., organizations not described in section 501(c)(3), including trade associations, social welfare organizations, social clubs, labor and agricultural organizations, and fraternal organizations) are required to file an application with the IRS to obtain a determination of their tax-exempt status. If an organization voluntarily files an application for recognition of exemption and receives a favorable determination from the IRS, the determination of tax-exempt status is usually effective as of the date of formation of the organization if its purposes and activities during the period prior to the date of the determination letter were consistent with the requirements for exemption. However, if the organization files an application for recognition of exemption and

later receives an adverse determination from the IRS, the IRS may assert that the organization is subject to tax on some or all of its income for open taxable years. In addition, as with charitable organizations, the IRS may revoke or modify an earlier favorable determination regarding an organization's tax-exempt status.

Under present law, a non-charity (i.e., an organization not described in section 501(c)(3)) may not seek a declaratory judgment with respect to an IRS determination regarding its tax-exempt status. The only remedies available to such an organization are to petition the U.S. Tax Court for relief following the issuance of a notice of deficiency or to pay any tax owed and sue for refund in federal district court or the U.S. Court of Federal Claims.

House Bill

The House bill extends declaratory judgment procedures similar to those currently available only to charities under section 7428 to other section 501(c) determinations. Jurisdiction over controversies involving such determinations is limited to the United States Tax Court.

Effective date.—The House bill is effective for pleadings with respect to determinations made after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

E. Modify Section 512(b)(13) (sec. 1006 of the bill and, Sec. 802 of the Senate amendment and section 512(b)(13) of the Code)

Present Law

In general, interest, rents, royalties and annuities are excluded from the unrelated business income ("UBI") of tax-exempt organizations. However, section 512(b)(13) treats otherwise excluded rent, royalty, annuity, and interest income as UBI if such income is received from a taxable or tax-exempt subsidiary that is 50 percent controlled by the parent tax-exempt organization. In the case of a stock subsidiary, "control" means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary).

Under present law, interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization are includable in the latter organization's UBI and are subject to the unrelated business income tax to the extent the payment reduces the

net unrelated income (or increases any net unrelated loss) of the controlled entity.

The Taxpayer Relief Act of 1997 (the "1997 Act") made several modifications, as described above, to the control requirement of section 512(b)(13). In order to provide transitional relief, the changes made by the 1997 Act do not apply to any payment received or accrued during the first two taxable years beginning on or after the date of enactment of the 1997 Act (August 5, 1997) if such payment is received or accrued pursuant to a binding written contract in effect on June 8, 1997, and at all times thereafter before such payment (but not pursuant to any contract provision that permits optional accelerated payments).

House Bill

The House bill provides that the general rule of section 512(b)(13), which includes interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization in the latter organization's UBI, applies only to the portion of payments received in a taxable year that exceed the amount of the specified payment which would have been paid if such payment had been determined under the principles of section 482. Thus, if a payment of rent by a controlled subsidiary to its tax-exempt parent organization exceeds fair market value, the excess amount of such payment over fair market value (as determined in accordance with section 482) is included in the parent organizations's UBI. The House bill also imposes an addition to tax of 20 percent of the excess amount of any such payment.

The House bill provides relief for payments under contracts that are still subject to the binding contract transition rule of the 1997 Act on the date of enactment of the proposal (but for which the transition rule would expire prior to the effective date of the proposal) by extending the transition rule until December 31, 1999.

Effective date.—The provision providing an exception from the general rule of section 512(b)(13) for interest, rent, annuity, or royalty payments from controlled subsidiaries that do not exceed fair market value generally applies to payments received or accrued after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

F. Simplify Lobbying Expenditure Limitations (sec. 803 of the Senate amendment and secs. 501(h) and 4911 of the Code)

Present Law

An organization does not qualify for tax-exempt status as a charitable organization under section 501(c)(3) unless no substantial part of its activities constitutes carrying on propaganda or oth-

erwise attempting to influence legislation (commonly referred to as "lobbying"). For purposes of determining whether legislative activities are a substantial part of a public charity's overall functions, a public charity may elect either the "substantial part" test or the "expenditure" test.

The substantial part test uses a facts and circumstances approach to measure the permissible level of legislative activities. Because there is no statutory or regulatory guidance, it is not clear whether the determination is based on the organization's activities, its expenditures, or both.

As an alternative to the substantial part test, the expenditure test permits public charities to elect to be governed by specific expenditure limitations on their lobbying activities under section 501(h). The expenditure test establishes two expenditure limits: one restricts the total amount of lobbying expenditures the public charity can make, the other restricts grass roots lobbying expenditures as a subset of total lobbying expenditures. A public charity's total lobbying expenditures for a year are the sum of its expenditures for direct lobbying and its expenditures for grass roots lobbying.

Direct lobbying is defined as an attempt to influence legislation through communication with a member or staff of a legislative body or with any other government official or employee who may participate in the formulation of legislation. The communication will constitute direct lobbying only if such communication "refers to specific legislation" and reflects a view on such legislation (Treas. Reg. sec. 56.4911–2(b)(1)(ii)). Grass roots lobbying is defined as an attempt to influence legislation through a communication with members of the public that seeks to affect their opinions about the legislation (Treas. Reg. sec. 56.4911–2(b)(2)(i)). The communication must refer to specific legislation, reflect a view on the legislation, and encourage the recipient of the communication to take action with respect to the legislation.

Under the expenditure test, a public charity will be denied exemption under section 501(c)(3) because of lobbying activities only if it normally either (1) makes total lobbying expenditures in excess of the "lobbying ceiling amount" or (2) makes grass roots expenditures in excess of the "grass roots ceiling amount" (sec. 501(h)(1)). The lobbying ceiling amount is 150 percent of the organization's "lobbying nontaxable amount" and the grass roots ceiling amount is 150 percent of the "grass roots nontaxable amount." The lobbying nontaxable amount is the lesser of $1 million or an amount determined as a percentage of an organization's exempt purpose expenditures. The grass roots nontaxable amount is 25 percent of the organization's lobbying nontaxable amount for that taxable year. A public charity that has elected the expenditure test and that exceeds either or both of these limitations is subject to a 25 percent tax on the greater of the two excess lobbying expenditures.

House Bill

No provision.

Senate Amendment

The Senate amendment removes the separate percentage limitation on grass roots lobbying expenditures. Consequently, public charities that have elected the expenditure test under section 501(h) are subject to an expenditure limitation only on their total lobbying expenditures.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

G. Tax-Free Withdrawals From IRAs for Charitable Purposes (sec. 804 of the Senate amendment and sec. 408(d) of the Code)

Present Law

Under present law, individuals may make deductible contributions to a traditional individual retirement arrangement ("IRA"). Amounts in an IRA are includible in income when withdrawn (except to the extent the withdrawal represents a return of after-tax contributions). Includible amounts withdrawn before attainment of age 59½ are subject to an additional 10-percent early withdrawal tax, unless an exception applies.

Generally, a taxpayer who itemizes deductions may deduct cash contributions to charity, as well as the fair market value of contributions of property. The amount of the deduction otherwise allowable for the 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.

For donations of cash by individuals, total deductible contributions to public charities may not exceed 50 percent of a taxpayer's adjusted gross income ("AGI") for a taxable year. To the extent a taxpayer has not exceeded the 50-percent limitation, contributions of cash to private foundations and certain other nonprofit organizations and contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's AGI. If a taxpayer makes a contribution in one year which exceeds the applicable 50-percent or 30-percent limitation, the excess amount of the contribution may be carried over and deducted during the next five taxable years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is indexed annually for inflation. The threshold amount for 1999 is $126,600 ($63,300 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by 3 percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. The ef-

fect of this reduction may be to limit a taxpayer's ability to deduct some of his or her charitable contributions.

House Bill

No provision.

Senate Amendment

The provision provides an exclusion from gross income for qualified charitable distributions from an IRA: (1) to a charitable organization to which deductible contributions can be made; (2) to a charitable remainder annuity trust or charitable remainder unitrust; (3) to a pooled income fund (as defined in sec. 642(c)(5)); or (4) for the issuance of a charitable gift annuity. The exclusion applies with respect to distributions described in (2), (3), or (4) only if no person holds an income interest in the trust, fund, or annuity attributable to such distributions other than the IRA owner, his or her spouse, or a charitable organization.

In determining the character of distributions from a charitable remainder annuity trust or a charitable remainder unitrust to which a qualified charitable distribution from an IRA was made, the charitable remainder trust is required to treat as ordinary income the portion of the distribution from the IRA to the trust which would have been includible in income but for the provision, and as corpus any remaining portion of the distribution. Similarly, in determining the amount includible in gross income by reason of a payment from a charitable gift annuity purchased with a qualified charitable distribution from an IRA, the taxpayer is not permitted to treat the portion of the distribution from the IRA used to purchase the annuity as an investment in the annuity contract.

A qualified charitable distribution is any distribution from an IRA which is made after age 70½, which qualifies as a charitable contribution (within the meaning of sec. 170(c)), and which is made directly to the charitable organization or to a charitable remainder annuity trust, charitable remainder unitrust, pooled income fund, or charitable gift annuity (as described above).[88] A taxpayer is not permitted to claim a charitable contribution deduction for amounts transferred from his or her IRA to charity or to a trust, fund, or annuity that, because of the provision, are excluded from the taxpayer's income.

Effective date.—The provision is effective with respect to distributions after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment, except that an exclusion from gross income for a qualified charitable distribution from an IRA is available only for a distribution made to a charitable organization to which deductible contributions can be made, and not for distributions to charitable remainder trusts,

[88] The Committee intends that, in the case of transfer to a trust, fund, or annuity, the full amount distributed from an IRA will meet the definition of a qualified charitable distribution if the charitable organization's interest in the distribution would qualify as a charitable contribution under section 170.

pooled income funds, or for the issuance of charitable gift annuities.

Effective date.—The provision is effective for distributions in taxable years beginning after December 31, 2002.

H. Provide Exclusion for Mileage Reimbursements by Charitable Organizations (sec. 1302 of the House bill, sec. 805 of the Senate amendment, and new sec. 138A of the Code)

Present Law

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity (sec. 170). Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to providing donated services to a qualified charitable organization—such as out-of-pocket transportation expenses necessarily incurred in performing donated services—may constitute a deductible contribution (Treas. Reg. sec. 1.170A–1(g)).[89] However, no charitable contribution deduction is allowed for traveling expenses (including expenses for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel (sec. 170(j)). Moreover, a taxpayer may not deduct as a charitable contribution out-of-pocket expenditures incurred on behalf of a charity if such expenditures are made for the purposes of influencing legislation (sec. 170(f)(6)).

For purposes of computing the charitable contribution deduction for the use of a passenger automobile (including vans, pickups, and panel trucks) in connection with providing donated services to a qualified charitable organization, the standard mileage rate is 14 cents per mile (sec. 170(i)). Volunteer drivers who are reimbursed for mileage expenses have taxable income to the extent the reimbursement exceeds 14 cents per mile.

House Bill

Under the House bill, reimbursement by an entity or organization described in section 170(c) (including public charities and private foundations) for the costs of using an automobile in connection with providing donated services is excludable from the gross income of the volunteer, provided that (1) reimbursement does not exceed the rate prescribed for business use, and (2) applicable recordkeeping requirements are satisfied. The expenditures for which a volunteer is reimbursed must be expenditures for which a deduction would otherwise be allowable under section 170. The bill does

[89] Treasury Regulation section 1.170A–1(g) allows taxpayers to deduct only their own unreimbursed expenses incurred in performing services for a qualified charitable organization, and not expenses incident to a third party's performance of services. See *Davis* v. *United States*, 495 U.S. 472 (1990).

not permit a volunteer to exclude a reimbursement from income if the volunteer claims a deduction or credit with respect to his or her automobile transportation expenses incurred in connection with providing donated services.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

I. Charitable Contribution Deduction for Certain Expenses in Support of Native Alaskan Subsistence Whaling (sec. 806 of the Senate amendment and sec. 170 of the Code)

Present Law

In computing taxable income, individuals who do not elect the standard deduction may claim itemized deductions, including a deduction (subject to certain limitations) for charitable contributions or gifts made during the taxable year to a qualified charitable organization or governmental entity (sec. 170). Individuals who elect the standard deduction may not claim a deduction for charitable contributions made during the taxable year.

No charitable contribution deduction is allowed for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization, contributions to which are deductible, may constitute a deductible contribution (Treas. Reg. sec. 1.170A–1(g)). Specifically, section 170(j) provides that no charitable contribution deduction is allowed for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel.

House Bill

No provision.

Senate Amendment

The Senate amendment allows individuals to claim a deduction under section 170 not exceeding $7,500 per taxable year for certain expenses incurred in carrying out sanctioned whaling activities. The deduction is available only to an individual who is recognized by the Alaska Eskimo Whaling Commission as a whaling captain charged with the responsibility of maintaining and carrying out sanctioned whaling activities. The deduction is available for reasonable and necessary expenses paid by the taxpayer during the taxable year for (1) the acquisition and maintenance of whaling boats, weapons, and gear used in sanctioned whaling activities, (2) the supplying of food for the crew and other provisions for carrying out

such activities, and (3) storage and distribution of the catch from such activities.

For purposes of the provision, the term "sanctioned whaling activities" means subsistence bowhead whale hunting activities conducted pursuant to the management plan of the Alaska Eskimo Whaling Commission. No inference is intended regarding the deductibility of any whaling expenses incurred in a taxable year ending before January 1, 2000.

Effective date.—The Senate amendment is effective for taxable years ending after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

J. Charitable Giving Provisions (secs. 807–809 of the Senate amendment and secs. 170 and 63 of the Code)

Present Law

Generally, a taxpayer who itemizes deductions may deduct cash contributions to charity made within a taxable year (generally, January 1–December 31 for calendar-year taxpayers), as well as the fair market value of contributions of property. The amount of the deduction otherwise allowable for the 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. Taxpayers who do not itemize their deductions may not claim a deduction for charitable contributions made during the taxable year.

For donations of cash by individuals, total deductible contributions to public charities, private operating foundations, and certain types of private non-operating foundations may not exceed 50 percent of a taxpayer's "contribution base," which is typically the taxpayer's adjusted gross income ("AGI"), for a taxable year (sec. 170(b)(1)). To the extent a taxpayer has not exceeded the 50-percent limitation, contributions of cash to private foundations and certain other charitable organizations and contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's contribution base. If a taxpayer makes a contribution in one year which exceeds the applicable 50-percent or 30-percent limitation, the excess amount of the contribution may be carried over and deducted during the next five taxable years.

The maximum charitable contribution deduction that may be claimed by a corporation for any one taxable year is limited to 10 percent of the corporation's taxable income for that year. (sec. 170(b)(2)).

House Bill

No provision.

Senate Amendment

Deadline for contributions to low-income schools extended until return filing date

The Senate amendment allows taxpayers to claim a charitable contribution deduction for donations to public, private, and parochial low-income elementary and secondary schools made after the end of the taxable year and on or before the date for filing the taxpayer's Federal income tax return (not including extensions). For example, a calendar-year taxpayer may make a contribution to a qualifying school on March 23, 2001, and claim a charitable contribution deduction for that gift on his or her Federal income tax return for the year 2000 filed on April 15, 2001.[90] For purposes of the provision, a low-income school is defined as one where more than 50 percent of the students qualify for free or reduced price lunches.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 1999.

Charitable contribution deduction for non-itemizers

For 2005 and 2006, the Senate amendment allows taxpayers who do not itemize their deductions to claim a deduction for charitable contributions in addition to the standard deduction. The deduction is limited to $50 for individual taxpayers and $100 for taxpayers filing joint returns. The deduction is available for any donation that is allowable as a deductible charitable contribution under section 170(a). Thus, contributions of cash, as well as tangible personal property (e.g., clothing and furniture), are eligible for the deduction.

Effective date.—The Senate amendment is effective for taxable years 2005 and 2006.

Increase AGI percentage limits for individuals

The Senate amendment phases up the percentage limitations applicable to charitable contributions of cash and capital gain property to public charities and certain other charitable entities (organizations and entities described in section 170(b)(1)(A)) by individuals. Beginning in 2002, the Senate amendment increases the 50-percent and 30-percent limitations by 2 percent per year until the limitations are equal to 60 percent and 30 percent, respectively, in 2006. In 2007, the limitations are increased to 70 percent and 50 percent, respectively.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

Increase AGI percentage limits for corporations

The Senate amendment phases up the percentage limitation applicable to charitable contributions by corporations. Beginning in 2002, the Senate amendment increases the 10-percent limitation by 2 percent per year until the limitation is equal to 20 percent in 2006.

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[90] The taxpayer will not be permitted to claim a deduction for the same gift on his or her 2001 Federal income tax return filed in 2002.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

Conference Agreement

The conference agreement does not include the Senate amendment charitable giving provisions.

K. Modify Excess Business Holdings Rules for Publicly Traded Stock (sec. 810 of the Senate amendment and sec. 4943 of the Code)

Present Law

Private foundations, which are charitable organizations that do not qualify as public charities, are subject to certain restrictions on their operations. Violations of these restrictions may subject the foundation and, in some cases, their foundation managers to excise taxes. One such restriction prohibits a private foundation from owning more than specified equity interests in business enterprises, including corporations, partnerships, estates, or trusts (sec. 4943). A private foundation, together with all disqualified persons, generally may not hold more than 20 percent of a corporation's voting stock, a partnership's profits interest, or similar interest in a business enterprise.[91] The limit increases to 35 percent if effective control of the business is in the hands of one or more persons who are not disqualified persons. These rules do not apply if the foundation owns less than 2 percent of a business, or if the business engages in activities that are substantially related to the foundation's charitable purpose.

If a foundation acquires business holdings other than by purchase (i.e., by gift or bequest), and the holdings would result in the foundation having excess business holdings, the foundation effectively has five years to reduce those holdings to permissible levels. In the case of an unusually large gift or bequest, the initial five-year disposition period may be extended by the Internal Revenue Service for an additional five years if the foundation is able to demonstrate that it has made diligent efforts to dispose of the excess holdings within the initial five-year period and that disposition within that period was not possible (except at a price substantially below fair market value) because of the size and complexity or diversity of the holdings.

The initial tax imposed on a foundation with excess business holdings is 5 percent of the value of such holdings during the taxable year. The amount of tax is computed with respect to the greatest amount of excess business holdings during the taxable year. If the foundation fails to divest itself of the excess holdings within a

[91] A disqualified person is a person (including an individual, corporation, partnership, trust, or estate) that has a particularly influential relationship with respect to a private foundation. Disqualified persons include: (1) substantial contributors to a foundation (e.g., the founder of a foundation); (2) foundation managers (officers, directors, or trustees of a foundation, or an individual having powers or responsibilities similar to these positions); (3) persons who own more than a 20 percent interest in an entity (corporation, partnership, trust, or other unincorporated enterprise) that is a disqualified person with respect to a foundation; (4) family members of persons described in (1), (2), and (3); (5) corporations, partnerships, trusts, or estates that are more than 35 percent owned by persons described in (1), (2), (3), and (4); and (6) only for purposes of the self-dealing rules of section 4943, government officials at certain levels.

certain period of time, an additional tax equal to 200 percent of their value is imposed on the excess business holdings remaining at the end of the period.

Present law also prohibits transactions between private foundations and disqualified persons by imposing excise taxes when disqualified persons engage in acts of "self-dealing" with a private foundation (sec. 4941). Acts of self-dealing include any direct or indirect: (1) sale, exchange, or leasing of property between a private foundation and a disqualified person, (2) lending of money or extensions of credit between a private foundation and a disqualified person, (3) furnishing of goods, services, or facilities between a private foundation and a disqualified person, (4) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person, (5) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation, and (6) agreement by a private foundation to make any payment of money or other property to a government official.[92] There is no exception from the prohibition on acts of self-dealing for inadvertent violations, and even transactions which arguably may benefit the private foundation may be subject to tax as an act of self-dealing.

Self-dealing excise taxes are imposed on a disqualified person who has engaged in a self- dealing transaction, and on any foundation manager who knowingly participates in the transaction.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an exception to the excess business holdings rules of section 4943 in certain circumstances. Under the Senate amendment, for the taxable year 2007, a private foundation and all disqualified persons are permitted to own up to 40 percent of the voting stock and 40 percent in value of all outstanding shares of all classes of stock in an incorporated business enterprise if the stock held by the foundation and disqualified persons is publicly traded stock for which market quotations are readily available. For the taxable year 2008 and thereafter, the percentage of stock that may be owned by a private foundation and all disqualified persons for purposes of this provision increases to 49 percent.

The Senate amendment limits the extent to which disqualified persons with respect to the foundation can engage in transactions with up to 49-percent owned corporations. Disqualified persons are not permitted to receive compensation from the corporation or to engage in any act with the corporation that would constitute self-dealing under section 4941 if the corporation were a private foundation and the disqualified persons were disqualified persons with respect to such corporation. Disqualified persons may not own, in the aggregate, more than 2 percent of the voting stock and not more than 2 percent in value of all outstanding shares of all classes

[92] There are certain limited transactions between disqualified persons and private foundations that are defined by statute not to constitute acts of self-dealing.

of stock in such corporation. Finally, an audit committee of the board of directors (consisting of a majority of persons who are not disqualified persons) of each corporation that is up to 49-percent owned by a private foundation must certify in writing to the foundation that the committee is not aware, after due inquiry, that any disqualified person has received compensation from the corporation or has engaged in an act of self-dealing with the corporation. This certification must be filed by the private foundation with its annual information return.

Effective date.—The provision is effective for foundations established by bequest of decedents dying after December 31, 2006.

Conference Agreement

The conference agreement does not include the Senate amendment.

L. Certain Costs of Private Foundation in Removing Hazardous Substances Treated as Qualifying Distribution (sec. 811 of the Senate amendment and sec. 4942 of the Code)

Present Law

Tax-exempt private foundations generally are required to make annual "qualifying distributions" of a specified minimum amount called the "distributable amount" (sec. 4942). The "distributable amount" is an amount equal to 5 percent of the fair market value of the foundation's investment assets for the year, reduced by (1) any excise tax on the foundation's investment income (under sec. 4940), (2) any tax on unrelated business taxable income (under sec. 511), and (3) by carryovers of excess distributions from prior years. "Qualifying distributions" include direct expenditures to accomplish charitable purposes and grants to public charities or private operating foundations. In addition, if certain requirements are met, a qualifying distribution also may include amounts "set aside" to be paid within five years for a specific charitable project.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, the distributable amount of a private foundation for purposes of section 4942 is reduced by any amounts paid or incurred for (1) investigatory costs, (2) direct costs of removal, and (3) costs of remedial action with respect to a hazardous substance released at a facility which was owned or operated by the private foundation. The provision is limited to a facility that was transferred to the foundation before December 11, 1980, for which active operation by the foundation was terminated before December 12, 1980. In addition, the provision does not apply to costs that were incurred pursuant to a pending order issued to the foundation unilaterally by the President or the President's assignee under section 106 of the Comprehensive Response, Compensation and Liability Act, or pursuant to a nonconsensual judgement

against the foundation in a governmental costs recovery action under section 107 of such Act. For purpose of this provision, "hazardous substance" has the meaning given to such term by section 9601(14) of the Comprehensive Environmental Compensation and Liability Act.

Effective date.—Taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement does not include the Senate amendment.

XI. REAL ESTATE TAX RELIEF PROVISIONS

A. Provisions Relating to REITs (secs. 1101–1106, 1111, 1121, 1131, 1141, and 1151 of the House bill, secs. 1021–1026, 1031, 1041, 1051, 1061 and 1071 of the Senate amendment, and secs. 852, 856, and 857 of the Code)

Present Law

Real estate investment trust ("REITs") are treated, in substance, as pass-through entities under present law. Pass-through status is achieved by allowing the REIT a deduction for dividends paid to its shareholders. REITs are restricted to investing in passive investments primarily in real estate and securities. Specifically, a REIT is required to receive at least 95 percent of its income from real property rents and from securities. Amounts received as impermissible "tenant services income" are not treated as rents from real property. In general, such amounts are for services rendered to tenants that are not "customarily furnished" in connection with the rental of real property. Rents for certain personal property leased in connection with real property are treated as rents from real property if the adjusted basis of the personal property does not exceed 15 percent of the aggregate adjusted bases of the real and the personal property. Special rules also permit amounts to be received from certain "foreclosure property," treated as such for 3 years after the property is acquired by the REIT in foreclosure after a default (or imminent default) on a lease of such property or on indebtedness which such property secured.

A REIT is not treated as providing services that produce impermissible tenant services income if such services are provided by an independent contractor from whom the REIT does not derive or receive any income. An independent contractor is defined as a person who does not own, directly or indirectly, more than 35 percent of the shares of the REIT. Also, no more than 35 percent of the total shares of stock of an independent contractor (or of the interests in assets or net profits, if not a corporation) can be owned directly or indirectly by persons owning 35 percent or more of the interests in the REIT.

A REIT is limited in the amount that it can own in other corporations. Specifically, a REIT cannot own securities (other than Government securities and certain real estate assets) in an amount greater than 25 percent of the value of REIT assets. In addition, it cannot own securities of any one issuer representing more than

5 percent of the total value of REIT assets or more than 10 percent of the voting securities of any corporate issuer. Under an exception to this rule, a REIT can own 100 percent of the stock of a corporation, but in that case the income and assets of such corporation are treated as income and assets of the REIT. Securities for purposes of these rules are defined by reference to the Investment Company Act of 1940.[93]

A REIT is generally required to distribute 95 percent of its income before the end of its taxable year, as deductible dividends paid to shareholders. This rule is similar to a rule for regulated investment companies ("RICs") that requires distribution of 90 percent of income. Both REITS and RICs can make certain "deficiency dividends" after the close of the taxable year, and have these treated as made before the end of the year. The regulations applicable to REITS state that a distribution will be treated as a "deficiency dividend" and thus as made before the end of the prior taxable year, only to the extent the earnings and profits for that year exceed the amount of distributions actually made during the taxable year.

A REIT that has been or has combined with a C corporation will be disqualified if, as of the end of its taxable year, it has accumulated earnings and profits from a non-REIT year. A similar rule applies to regulated investment companies ("RICs"). In the case of a REIT, any distribution made in order to comply with this requirement is treated a being first from pre-REIT accumulated earnings and profits. RICs do not have a similar ordering rule.

In the case of a RIC, under a provision entitled "procedures similar to deficiency dividend procedures", any distribution made within a specified period after determination that the investment company did not qualify as a RIC for the taxable year will, "for purposes of applying [the earnings and profits rule that forbids a RIC to have non-RIC earnings and profits] to subsequent taxable years", be treated as applying to the RIC for the non-RIC year. The REIT rules do not specify any particular separate treatment of distributions made after the end of the taxable year for purposes of the earnings and profits rule. Treasury regulations under the REIT provisions state that "distribution procedures similar to those . . . for regulated investment companies apply to non-REIT earnings and profits of a real estate investment trust."

House Bill

Taxable REIT subsidiaries

Under the provision, a REIT generally cannot own more than 10 percent of the total value of securities of a single issuer, in addition to the present law rule that a REIT cannot own more than 10 percent of the outstanding voting securities of a single issuer.

For purposes of the new 10-percent value test, securities are generally defined to exclude safe harbor debt owned by a REIT (as defined for purposes of sec. 1361(c)(5)(B)(i) and (ii)) if the REIT (and any taxable REIT subsidiary of such REIT) owns no other securities of the issuer. However, in the case of a REIT that owns se-

[93] 15 U.S.C. 80a–1 and following.

curities of a partnership, safe harbor debt is excluded from the definition of securities only if the REIT owns at least 20-percent or more of the profits interest in the partnership. The purpose of the partnership rule requiring a 20-percent profits interest is to assure that if the partnership produces income that would be disqualified income to the REIT, the REIT will be treated as receiving a significant portion of that income directly, even though it may also derive qualified interest income through its safe harbor debt interest.

An exception to the limitations on ownership of securities of a single issuer applies in the case of a "taxable REIT subsidiary" that meets certain requirements. To qualify as a taxable REIT subsidiary, both the REIT and the subsidiary corporation must join in an election. In addition, any corporation (other than a REIT or a qualified REIT subsidiary under section 856(i) that does not properly elect with the REIT to be a taxable REIT subsidiary) of which a taxable REIT subsidiary owns, directly or indirectly, more than 35 percent of the vote or value is automatically treated as a taxable REIT subsidiary. Securities (as defined in the Investment Company Act of 1940) of taxable REIT subsidiaries could not exceed 25 percent of the total value of a REIT's assets.

A taxable REIT subsidiary can engage in certain business activities that under present law could disqualify the REIT because, but for the proposal, the taxable REIT subsidiary's activities and relationship with the REIT could prevent certain income from qualifying as rents from real property. Specifically, the subsidiary can provide services to tenants of REIT property (even if such services were not considered services customarily furnished in connection with the rental of real property), and can manage or operate properties, generally for third parties, without causing amounts received or accrued directly or indirectly by REIT for such activities to fail to be treated as rents from real property.

However, the subsidiary cannot directly or indirectly operate or manage a lodging or healthcare facility. Nevertheless, it can lease a qualified lodging facility (e.g, a hotel) from the REIT (provided no gambling revenues were derived by the hotel or on its premises); and the rents paid are treated as rents from real property so long as the lodging facility was operated by an independent contractor for a fee. The subsidiary can bear all expenses of operating the facility and receive all the net revenues, minus the independent contractor's fee.

For purposes of the rule that an independent contractor may operate a qualified lodging facility, an independent contractor will qualify so long as, at the time it enters into the management agreement with the taxable REIT subsidiary, it is actively engaged in the trade or business of operating qualified lodging facilities for any person who is not related to the REIT or the taxable REIT subsidiary. The REIT may receive income from such an independent contractor with respect to certain pre-existing leases.

Also, the subsidiary generally cannot provide to any person rights to any brand name under which hotels or healthcare facilities are operated. An exception applies to rights provided to an independent contractor to operate or manage a lodging facility, if the rights are held by the subsidiary as licensee or franchisee, and

the lodging facility is owned by the subsidiary or leased to it by the REIT.

Interest paid by a taxable REIT subsidiary to the related REIT is subject to the earnings stripping rules of section 163(j). Thus the taxable REIT subsidiary cannot deduct interest in any year that would exceed 50 percent of the subsidiary's adjusted gross income.

If any amount of interest, rent, or other deductions of the taxable REIT subsidiary for amounts paid to the REIT is determined to be other than at arm's length ("redetermined" items), an excise tax of 100 percent is imposed on the portion that was excessive. "Safe harbors" are provided for certain rental payments where the amounts are de minimis, there is specified evidence that charges to unrelated parties are substantially comparable, certain charges for services from the taxable REIT subsidiary are separately stated, or the subsidiary's gross income from the service is not less than 150 percent of the subsidiary's direct cost in furnishing the service.

In determining whether rents are arm's length rents, the fact that such rents do not meet the requirements of the specified safe harbors shall not be taken into account. In addition, rent received by a REIT shall not fail to qualify as rents from real property by reason of the fact that all or any portion of such rent is redetermined for purposes of the excise tax.

The Commissioner of Internal Revenue is to conduct a study to determine how many taxable REIT subsidiaries are in existence and the aggregate amount of taxes paid by such subsidiaries. A report shall be submitted to the Congress describing the results of such study.

Health care REITS

The provision permits a REIT to own and operate a health care facility for at least two years, and treat it as permitted "foreclosure" property, if the facility is acquired by the termination or expiration of a lease of the property. Extensions of the 2 year period can be granted.

Conformity with regulated investment company rules

Under the provision, the REIT distribution requirements are modified to conform to the rules for regulated investment companies. Specifically, a REIT is required to distribute only 90 percent, rather than 95 percent, of its income.

Definition of independent contractor

If any class of stock of the REIT or the person being tested as an independent contractor is regularly traded on an established securities market, only persons who directly or indirectly own 5 percent or more of such class of stock shall be counted in determining whether the 35 percent ownership limitations have been exceeded.

Modification of earnings and profits rules for RICs and REITS

The rule allowing a RIC to make a distribution after a determination that it had failed RIC status, and thus meet the requirement of no non-RIC earnings and profits in subsequent years, is

modified to clarify that, when the reason for the determination is that the RIC had non-RIC earnings and profits in the initial year, the procedure would apply to permit RIC qualification in the initial year to which such determination applied, in addition to subsequent years.

The RIC earnings and profits rules are also modified to provide an ordering rule similar to the REIT rule, treating a distribution to meet the requirements of no non-RIC earnings and profits as coming first from the earliest earnings and profits accumulated in any year for which the RIC did not qualify as a RIC. In addition, the REIT deficiency dividend rules are modified to apply the same earnings and profits ordering rule to such dividends as other REIT dividends.

Effective date

The House bill is generally effective for taxable years beginning after December 31, 2000. The provision with respect to modification of earnings and profits rules is effective for distributions after December 31, 2000.

In the case of the provisions relating to permitted ownership of securities of an issuer, special transition rules apply. The new rules forbidding a REIT to own more than 10 percent of the value of securities of a single issuer do not apply to a REIT with respect to securities held directly or indirectly by such REIT on July 12, 1999, or acquired pursuant to the terms of written binding contract in effect on that date and at all times thereafter until the acquisition. Also, securities received in a tax-free exchange or reorganization, with respect to or in exchange for such grandfathered securities would be grandfathered. This transition ceases to apply to securities of a corporation as of the first day after July 12, 1999 on which such corporation engages in a substantial new line of business, or acquires any substantial asset, other than pursuant to a binding contract in effect on such date and at all times thereafter, or in a reorganization or transaction in which gain or loss is not recognized by reason of section 1031 or 1033 of the Code. If a corporation makes an election to become a taxable REIT subsidiary, effective before January 1, 2004 and at a time when the REIT's ownership is grandfathered under these rules, the election is treated as a reorganization under section 368(a)(1)(A) of the Code.

Senate Amendment

The Senate amendment is the same as the House bill with certain clarifications and one additional provision.

General clarifications

The Senate amendment clarifies that straight-debt securities of an individual issuer are not treated as securities for purposes of the new prohibition on a REIT owning 10 percent of the value of a single issuer.

The Senate amendment clarifies the definition of "redetermined deductions" for purposes of the 100 percent excise tax, to indicate that these are deductions of the taxable REIT subsidiary that would be reduced (not increased) under the arm's length rules of section 482.

The Senate amendment clarifies the application of the transition rule permitting a REIT to own more than 10 percent of the value of securities of an issuer if such securities are held by the REIT on July 12, 1999. Under the Senate amendment, the grandfathering of such securities ceases to apply if the REIT acquires additional securities of that issuer after that date, other than pursuant to a binding contract in effect on that date and at all times thereafter, or in a reorganization with another corporation the securities of which are grandfathered.

Rental income clarification

The Senate amendment clarifies that rents paid to a REIT are not generally qualified rents if the REIT owns more than 10 percent of the value, (as well as of the vote) of a corporation paying the rents. The amendment clarifies that the only exception is for rents that are paid by taxable REIT subsidiaries and that also meet the limited rental exception (where 90 percent of space is leased to third parties) or the exception for certain lodging facilities (operated by an independent contractor) specified in the House bill.

Effective date.—The new 10 percent of value limitation for purposes of defining qualified rents is effective for taxable years beginning after December 31, 1999. There is an exception for rents paid under a lease or pursuant to a binding contract in effect on July 12, 1999 and at all times thereafter.

Provision regarding rental income from certain personal property

The Senate amendment modifies the present law rule that permits certain rents from personal property to be treated as real estate rental income if such personal property does not exceed 15 percent of the aggregate of real and personal property. The Senate amendment replaces the present law comparison of the adjusted bases of properties with a comparison based on fair market values.

Effective date.—The provision regarding rental income from certain personal property is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

Effective date.—The effective dates of the conference agreement are the same as under the Senate amendment, except that the effective dates of (i) the clarification that a 10 percent of value ownership limitation applies to certain rents, and (2) the provision using a fair market value test for rental income from certain personal property, are for taxable years beginning after December 31, 2000 (rather than after December 31, 1999).

B. Modify At-Risk Rules for Publicly Traded Nonrecourse Debt (sec. 1161 of the House bill and sec. 465(b)(6) of the Code)

Present Law

Present law provides an at-risk limitation on losses from business and income-producing activities, applicable to individuals and certain closely held corporations (sec. 465). Under the at-risk rules, a taxpayer generally is not considered at risk with respect to borrowed amounts if the taxpayer is not personally liable for repayment of the debt (e.g., nonrecourse loans), and in certain other circumstances.

In the case of the activity of holding real property, however, an exception is provided for qualified nonrecourse financing that is secured by real property used in the activity (sec. 465(b)(6)). The qualified nonrecourse financing rules require, among other things, that the financing be borrowed by the taxpayer from a qualified person or from certain governmental entities. For this purpose, a qualified person is one that is actively and regularly engaged in the business of lending money (and that is not a related person with respect to the taxpayer, is not a person from whom the taxpayer acquired the property or a related person, and is not a person that receives a fee with respect to the taxpayer's investment or a related person (sec. 49(a)(1)(D)(iv)). A related person is one with certain types of relationships to the taxpayer defined by statute (sec. 465(b)(3)(C)). The qualified nonrecourse financing rules also require that the financing be secured by real property used in the activity (sec. 465(b)(6)(A)).

House Bill

The House bill modifies the rules relating to qualified nonrecourse financing to provide that, in the case of an activity of holding real property, a taxpayer is considered at risk with respect to the taxpayer's share of certain financing that is not borrowed from a person that is regularly engaged in the business of lending money, and that is not secured by real property used in the activity, if the financing is qualified publicly traded debt.

The financing may not be borrowed from a person that is a related person with respect to the taxpayer, that is a person from whom the taxpayer acquired the property or a related person, or that is a person that receives a fee with respect to the taxpayer's investment or a related person.

Qualified publicly traded debt generally means any debt instrument that is readily tradable on an established securities market. However, qualified publicly traded debt does not include any debt instrument, the yield to maturity on which equals or exceeds the applicable Federal rate of interest for the calendar month in which it is issued, plus 5 percentage points. The applicable Federal rate is the rate determined under section 1274(d) with respect to the term of the debt instrument. Under the provision, it is intended that "readily tradable on an established securities market" have the same meaning as under section 453(f)(5).

Effective date.—The provision is effective for debt instruments issued after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

C. Qualified Lessee Construction Allowances Not Limited to Short-term Leases for Certain Retailers (sec. 1171 of the House bill and sec. 110 of the Code)

Present Law

Section 110 provides that the gross income of a lessee does not include amounts received in cash (or treated as a rent reduction) from a lessor under a short-term lease of retail space for the purpose of the lessee's construction or improvement of qualified long-term real property for use in the lessee's trade or business at the retail space subject to the short-term lease. The exclusion only applies to the extent the allowance does not exceed the amount expended by the lessee on the construction or improvement of qualified long-term real property. For this purpose, "qualified long-term real property" means nonresidential real property that is part of, or otherwise present at, retail space used by the lessee and that reverts to the lessor at the termination of the lease. A "short-term lease" means a lease or other agreement for the occupancy or use of retail space for a term of 15 years or less (as determined pursuant to sec. 168(i)(3)). "Retail space" means real property leased, occupied, or otherwise used by the lessee in its trade or business of selling tangible personal property or services to the general public.

The lessor must treat the amounts expended on the construction allowance as nonresidential real property owned by the lessor. The Secretary is granted the authority to require reporting to ensure that both the lessor and lessee treat such amounts as nonresidential real property owned by the lessor.[94]

House Bill

The provision eliminates the section 110 requirement that the lease be for a term of 15 years or less in the case of payment (or rent reduction) to a "qualified retail business." Payments by a lessor to such businesses for the purpose of constructing or improving long-term real property would not be included in the income of the lessee regardless of the term of the lease, provided the payments are used for such purpose.

For this purpose, a qualified retail business would be defined as a trade or business of selling tangible personal property to the general public. A trade or business will not fail to be considered a

[94] Section 110 provides for regulations to be issued establishing the time and manner information must be provided the Secretary concerning amounts received (or treated as a rent reduction), amounts expended on qualified long-term real property, and such other information as the Secretary deems necessary to carry out the provision. These regulations have not yet been issued.

qualified retail business by reason of sales of services to the general public if such sales are incidental to the sale of tangible personal property (such as tailoring services provided incidental to the sale of a suit or dress) or are de minimis in amount. For this purpose, services would be considered de minimis in amount if they represent 10% or less of the gross receipts of the business at the retail space subject to the lease.

The provision does not eliminate the short-term lease requirement in all situations that are otherwise eligible for section 110 under present law. Section 110 presently applies (assuming the other standards are met) if the retail space of the lessee will be used in the trade or business of selling tangible personal property or services to the public. If the lessee will earn more than 10% of the gross receipts of the space from the sale of services (other than from services that are incidental to the sale of tangible personal property), section 110 will continue to be available only if the lease is for a term of 15 years or less.

Effective date.—The provision applies to leases entered into after December 31, 1999. No inference is intended as to the treatment of amounts that are not affected by the provision.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

D. Exclusion From Gross Income for Certain Contributions to the Capital of Certain Retailers (sec. 1172 of the House bill and sec. 118 of the Code)

Present Law

Section 118(a) provides that gross income does not include any contribution to the capital of a corporation. The test for determining whether a particular payment is a contribution to capital is the intent or motive of the transferor. The contribution (1) must become a part of the recipient's capital structure; (2) may not be compensation for a "specific, quantifiable service"; (3) must be bargained for; (4) must result in a benefit to the recipient; and (5) ordinarily will contribute to the production of additional income. *United States* v. *Chicago, Burlington & Quincy R.R.,* 412 U.S. 401, 411, 93 S. Ct. 2169, 2175, 37 L. Ed. 2d 30 (1973).

Two appellate courts have applied section 118(a) to inducements paid by developers to retailers in exchange for the agreement of the retailers to "anchor" future shopping centers. *Federated Department Stores* v. *Commissioner* 51 TC 500 (1968), aff'd 426 F. 2d 417 (6th Cir., 1970), *May Department Stores Co.* v. *Commissioner,* 33 TCM 1128 (1974), aff'd 519 F. 2d 1154 (8th Cir., 1975). In both cases, the courts held that the benefits anticipated by the developer were speculative and intangible, and thus could not be considered in payment for any particular service.

The recipient taxpayer is allowed no basis in any property it receives as a contribution to capital, or a property it acquires within 12 months with the proceeds of a contribution to capital (sec. 362).

A portion of a single payment may qualify as a nontaxable contribution to capital, while the remainder is considered to be part of a taxable transaction. Where there are multiple purposes to the payment, the payment may be examined to determine what portion is eligible for section 118(a) treatment. *G.M. Trading Corporation* v. *Commissioner,* 121 F. 3d 977 (5th Cir., 1997).

House Bill

The provision establishes a safe harbor allowing certain inducements received by retailers to be treated as nontaxable contributions to capital. In order to qualify for the safe harbor, the inducement must be in exchange for the retailer's agreement to operate a qualified retail business at particular location for a period of at least 15 years. The retailer must, immediately after the receipt of the contribution, own the land and structures to be used by the taxpayer in carrying on the qualified retail business at the agreed location and must satisfy an expenditure rule.

The safe harbor does not apply if the contributor owns a beneficial interest in property located on the premises of the qualified retail business, other than de minimis amounts of property associated with the operation of adjacent property. For example, a developer may be the owner of the pipes and related equipment making up the water system of a shopping mall. Ownership of such property on premises owned by the retailer is expected to be considered de minimis and would not prevent the application of the safeharbor. On the other hand, ownership of more than a de minimis amount of assets or the ownership of assets disqualifies the inducement from safeharbor treatment. For example, if a developer owns and leases to a retailer the retailer's point of sale equipment, any inducement paid by the developer to the retailer will not qualify under the safeharbor as a nontaxable contribution to capital.[95] The rule applies to property owned by the developer on the premises of the retailer. The premises of the retailer is the area in which the retailer holds out personal property for sale to the general public. The premises of the retailer do not include adjacent space, such as a parking facility under the store which is owned and operated by the developer whose use is not limited to customers of the taxpayer. The rule also does not prevent the developer paying the inducement from owning a beneficial interest in the retailers, or joining in a joint venture with the retailer unless the joint venture involves ownership of property on the premises of the retailer that would prevent the use of the safeharbor if owned directly by the developer.

The expenditure rule requires that, prior to the end of the second taxable year after the year in the contribution was received, the retailer spend an amount equal to the amount of the contribu-

[95] Ownership of property on the premises of the retailer by the developer does not automatically prevent an inducement from qualifying as a nontaxable contribution to capital under section 118(a), provided the taxpayer can establish the facts required for that provision to apply.

tion for the acquisition of land or structure, or for the acquisition or construction of other property to be used in the qualified retail business at the agreed location. Accurate records would be required to be kept that establish the satisfaction of the expenditure rule. It is not intended that the retailer be required to trace specific expenditures to the inducement.

A qualified retail business is defined as a trade or business of selling tangible personal property to the general public. A trade or business will not fail to be considered a qualified retail business by reason of sales of services to the general public if such sales are incidental to the sale of tangible personal property (such as tailoring services provided incidental to the sale of a suit or dress) or are de minimis in amount. For this purpose, services are considered de minimis in amount if they represent 10 percent or less of the gross receipts of the business at the retail space subject to the lease.

Anti-abuse rules are provided to prevent the use of the safeharbor for amounts that are not intended by the parties as contributions to capital. The Secretary is authorized to allocate income and deductions, or to reduce the amount of any contribution to capital under the safeharbor, in cases in which it is established that above market rates have been paid from the retailer to the developer in another transaction. A rate is not expected to be considered to be above market if it is the same on a square footage basis as the rate charged other retailers at the same location. For example, a developer charges all retailers in the mall a common area maintenance charge. If this charge is equal to a standard rate times the square footage of each store in the mall, it will not be considered to be an above market rate with respect to any single retailer.

The Secretary is also authorized to allocate income and deductions, or reduce the amount of any contribution to capital, to the extent necessary to prevent the abuse of the purposes of this section where the transaction takes place between related parties. It is expected that this authority will be used to prevent the conversion of nondepreciable or longer lived property into costs that may be recovered over a shorter period of time. For example, if a retailer who owns a piece of land contributes that land to a joint venture and then accept the land from the joint venture as an inducement to operate a retail facility for 20 years an anchor for a new mall, it is expected that the Secretary will use its authority to reduce the amount of any contribution to capital in a transaction between related parties to prevent the application of the safeharbor. However, it is not intended that the authority to will be used simply because the retailer and a related party engage in transactions that are concluded on an arm's-length basis and do not result in the conversion of nondepreciable or longer lived assets into costs that may be recovered over a shorter period of time.

The provision does not limit the application of section 118(a) of present law. No inference is intended as to whether any payment constitutes a nontaxable contribution to capital under section 118(a) whether or not such payment qualifies for the safeharbor provided by this provision.

Effective date.—The provision is effective for contributions received after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

E. Increase the Low-Income Housing Tax Credit Cap and Make Other Modifications (secs. 1331–1337 of the House Bill, sec. 1001 of the Senate amendment and sec. 42 of the Code)

Present Law

In general

The low-income housing tax credit may be claimed over a 10-year period for the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not Federally subsidized is adjusted monthly by the Internal Revenue Service so that the 10 annual installments have a present value of 70 percent of the total qualified expenditures. The credit percentage for new substantially rehabilitated housing that is Federally subsidized and for existing housing that is substantially rehabilitated is calculated to have a present value of 30 percent qualified expenditures.

Credit cap

The aggregate credit authority provided annually to each State is $1.25 per resident, except in the case of projects that also receive financing with proceeds of tax-exempt bonds issued subject to the private activity bond volume limit and certain carry-over amounts,

Expenditure test

Generally, the building must be placed in service in the year in which it receives an allocation to qualify for the credit. An exception is provided in the case where the taxpayer has expended an amount equal to 10 percent or more of the taxpayer's reasonably expected basis in the building by the end of the calendar year in which the allocation is received and certain other requirements are met.

Basis of building eligible for the credit

Buildings receiving assistance under the HOME investment partnerships act ("HOME") are not eligible for the enhanced credit for buildings located in high cost areas (i.e., qualified census tracts and difficult development areas). Under the enhanced credit, the 70-percent and 30-percent credit are increased to a 91-percent and 39-percent credit, respectfully.

Eligible basis is generally limited to the portion of the building used by qualified low-income tenants for residential living and some common areas.

State allocation plans

Each State must develop a plan for allocating credits and such plan must include certain allocation criteria including: (1) project location; (2) housing needs characteristics; (3) project characteristics; (4) sponsor characteristics; (5) participation of local tax-exempts; (6) tenant populations with special needs; and (7) public housing waiting lists. The State allocation plan must also give preference to housing projects: (1) that serve the lowest income tenants; and (2) that are obligated to serve qualified tenants for the longest periods.

Credit administration

There are no explicit requirements that housing credit agencies perform a comprehensive market study of the housing needs of the low-income individuals in the area to be served by the project, nor that such agency conduct site visits to monitor for compliance with habitability standards.

Stacking rule

Authority to allocate credits remains at the State (as opposed to local) government level unless State law provides otherwise.[96] Generally, credits may be allocated only from volume authority arising during the calendar year in which the building is placed in service, except in the case of: (1) credits claimed on additions to qualified basis; (2) credits allocated in a later year pursuant to an earlier binding commitment made no later than the year in which the building is placed in service; and (3) carryover allocations.

Each State annually receives low-income housing credit authority equal to $1.25 per State resident for allocation to qualified low-income projects.[97] In addition to this $1.25 per resident amount, each State's "housing credit ceiling" includes the following amounts: (1) the unused State housing credit ceiling (if any) of such State for the preceding calendar year;[98] (2) the amount of the State housing credit ceiling (if any) returned in the calendar year;[99] and (3) the amount of the national pool (if any) allocated to such State by the Treasury Department.

The national pool consists of States' unused housing credit carryovers. For each State, the unused housing credit carryover for a calendar year consists of the excess (if any) of the unused State housing credit ceiling for such year over the excess (if any) of the aggregate housing credit dollar amount allocated for such year over the sum of $1.25 per resident and the credit returns for such year. The amounts in the national pool are allocated only to a State

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[96] For example, constitutional home rule cities in Illinois are guaranteed their proportionate share of the $1.25 amount, based on their population relative to that of the State as a whole.

[97] A State's population, for these purposes, is the most recent estimate of the State's population released by the Bureau of the Census before the beginning of the year to which the limitation applies. Also, for these purposes, the District of Columbia and the U.S. possessions (i.e., Puerto Rico, the Virgin Islands, Guam, the Northern Marianas and American Samoa) are treated as States.

[98] The unused State housing credit ceiling is the amount (if positive) of the previous year's annual credit limitation plus credit returns less the credit actually allocated in that year.

[99] Credit returns are the sum of any amounts allocated to projects within a State which fail to become a qualified low-income housing project within the allowable time period plus any amounts allocated to a project within a State under an allocation which is canceled by mutual consent of the housing credit agency and the allocation recipient.

which allocated its entire housing credit ceiling for the preceding calendar year, and requested a share in the national pool not later than May 1 of the calendar year. The national pool allocation to qualified States is made on a pro rata basis equivalent to the fraction that a State's population enjoys relative to the total population of all qualified States for that year.

The present-law stacking rule provides that a State is treated as using its annual allocation of credit authority ($1.25 per State resident) and any returns during the calendar year followed by any unused credits carried forward from the preceding year's credit ceiling and finally any applicable allocations from the National pool.

House Bill

Credit cap

The $1.25 per capita cap is increased to $1.75 per capita. This increase is phased-in by increasing the credit cap by 10 cents per capita each year for five years. The credit cap would be: $1.35 in calendar year 2000; $1.45 in calendar 2001; $1.55 in calendar year 2002; $1.65 in calendar year 2003; and $1.75 in calendar year 2004. The $1.75 per capita credit cap is indexed for inflation beginning in 2004.

Expenditure test

The bill allows a building which receives an allocation in the second half of a calendar to qualify under the 10–percent test if the taxpayer expends an amount equal to 10–percent or more of the taxpayer's reasonably expected basis in the building within six months of receiving the allocation regardless of whether the 10–percent test is met by the end of the calendar year.

Basis of building eligible for the credit

The bill makes three changes to the basis rules of the credit. First, buildings receiving HOME assistance are made eligible for the enhanced credit. Second, the definition of qualified census tracts for purposes of the enhanced credit is expanded to include any census tracts with a poverty rate of 25 percent or more. Third, the bill extends the credit to a portion of the building used as a community service facility not in excess of 20 percent of the total eligible basis in the building. A community service facility is defined as any facility designed to serve primarily individuals whose income is 60 percent or less of area median income.

State allocation plans

The bill strikes the plan criteria relating to participation of local tax-exempts, replacing it with two other criteria: tenant populations of individuals with children and projects intended for eventual tenant ownership. It also provides that the present-law criteria relating to sponsor characteristics include whether the project involves the use of existing housing as part of a community revitalization plan. Also, the bill adds a third category of housing projects to the preferential list. That third category is for projects located

in qualified census tracts which contribute to a concerted community revitalization plan.

Credit administration

The bill requires a comprehensive market study of the housing needs of the low-income individuals in the area to be served by the project and a written explanation available to the general public for any allocation not made in accordance with the established priorities and selection criteria of the housing credit agency. It also requires site inspections by the housing credit agency to monitor compliance with habitability standards applicable to the project.

Stacking rule

The bill modifies the stacking rule so that each State would be treated as using its allocation of the unused State housing credit ceiling (if any) from the preceding calendar before the current year's allocation of credit (including any credits returned to the State) and then finally any National pool allocations.

Effective date

In general, the House bill is effective for calendar years beginning after December 31, 2000, and buildings placed-in-service after such date in the case of projects that also receive financing with proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after such date. The increase and indexing of the credit cap is effective for calendar years after December 31, 1999.

Senate Amendment

Credit cap

The Senate amendment makes two changes to the credit cap. First, the $1.25 per capita cap for each State modified so that small population State are given a minimum of $2 million of annual credit cap. Second, the $1.25 per capita element of the credit cap is increased to $1.75 per capita. This increase is phased-in by increasing the credit cap by 10 cents per capita each year for five years. Therefore the credit cap will be: $1.35 per capita or $2 million, whichever is greater, in calendar year 2001; $1.45 per capita or $2 million, whichever is greater, in calendar 2002; $1.55 per capita or $2 million, whichever is greater, in calendar year 2003; $1.65 per capita or $2 million, whichever is greater, in calendar year 2004; and $1.75 per capita or $2 million, whichever is greater, in calendar year 2005 and thereafter.

Expenditure test

No provision.

Basis of building eligible for the credit

The Senate amendment provides that assistance received under the Native American Housing Assistance and Self-Determination Act of 1996 is not taken into account in determining whether a building is Federally subsidized for purposes of the credit. This allows such buildings to qualify for something other than

the 30-percent credit generally applicable to Federally subsidized buildings.

State allocation plans

No provision.

Credit administration

No provision.

Stacking rule

Same as the House bill.

Effective date

The Senate amendment provision is effective for calendar years beginning after December 31, 2000.

Conference Agreement

Credit cap

The conference agreement follows the House bill with a modification. The modification provides a minimum of $2 million of annual credit cap to small population states beginning in calendar year 2000. The $2 million annual credit cap is indexed for inflation, beginning in the same year that indexing begins for the per capita cap.

Expenditure test

The conference agreement follows the House bill.

Basis of building eligible for the credit

The conference agreement includes two of the three House bill changes to the credit basis rules and the Senate amendment provision relating to assistance received under the Native American Housing Assistance and Self-Determination Act of 1996. The first House bill provision included in the conference agreement provides that the definition of qualified census tracts for purposes of the enhanced credit is expanded to include any census tracts with a poverty rate of 25 percent or more. The second House bill provision included in the conference agreement is modified so that it extends the credit to a portion of the building used as a community service facility not in excess of 10 percent of the total eligible basis in the building. A community service facility is defined as any facility designed to serve primarily individuals whose income is 60 percent or less of area median income. The House bill provision relating to buildings receiving HOME assistance being made eligible for the enhanced credit is not included in the conference agreement.

State allocation plans

The conference agreement includes the House bill provision.

Credit administration

The conference agreement includes the House bill provision.

Stacking rule

The conference agreement follows the House bill and the Senate amendment.

Effective date

The provision is generally effective for calendar years beginning after December 31, 1999, and buildings placed-in-service after such date in the case of projects that also receive financing with proceeds of tax-exempt bonds subject to the private activity bond volume limit which are issued after such date.

The increase in the credit cap is contingent upon enactment as part of the bill of the separate provisions relating to State allocation plans and credit administration.

F. Tax Credit for Renovating Historic Homes (section 1011 of the Senate amendment and new section 25B of the Code)

Present Law

Present law provides an income tax credit for certain expenditures incurred in rehabilitating certified historic structures and certain nonresidential buildings placed in service before 1936 (Code sec. 47). The amount of the credit is determined by multiplying the applicable rehabilitation percentage by the basis of the property that is attributable to qualified rehabilitation expenditures. The applicable rehabilitation percentage is 20 percent for certified historic structures and 10 percent for qualified rehabilitated buildings (other than certified historic structures) that were originally placed in service before 1936.

A qualified rehabilitated building is a nonresidential building eligible for the 10–percent credit only if the building is substantially rehabilitated and a specific portion of the existing structure of the building is retained in place upon completion of the rehabilitation. A residential or nonresidential building is eligible for the 20–percent credit that applies to certified historic structures only if the building is substantially rehabilitated (as determined under the eligibility rules for the 10–percent credit). In addition, the building must be listed in the National Register or the building must be located in a registered historic district and must be certified by the Secretary of the Interior as being of historical significance to the district.

House bill

No provision.

Senate Amendment

The Senate amendment permits a taxpayer to claim a 20–percent credit for qualified rehabilitation expenditures made with respect to a qualified historic home which the taxpayer subsequently occupies as his or her principal residence for at least five years. The total credit which could be claimed by the taxpayer is limited to $20,000 ($10,000 in the case of married taxpayer filing a separate return) with respect to any qualified historic home.

The bill applies to (1) structures listed in the National Register; (2) structures located in a registered national, State, or local historic district, and certified by the Secretary of the Interior as being of historic significance to the district, but only if the median income of the historic district is less than twice the State median income; (3) any structure designated as being of historic significance under a State or local statute, if such statute is certified by the Secretary of the Interior as achieving the purpose of preserving and rehabilitating buildings of historic significance.

For this purpose, a building generally is considered substantially rehabilitated if the qualified rehabilitation expenditures incurred during a 24–month measuring period exceed the greater of (1) the adjusted basis of the building as of the later of the first day of the 24–month period or the beginning of the taxpayer's holding period for the building, or (2) $5,000. In the case of structures in empowerment zones, in enterprise communities, in a census tract in which 70 percent of families have income which is 80 percent or less of the State median family income, and areas of chronic distress as designated by the State and approved by the Secretary of Housing and Urban Development only the $5,000 expenditure requirement applies. In addition, for all structures, at least 5 percent of the rehabilitation expenditures have to be allocable to the exterior of the structure.

To qualify for the credit, the rehabilitation must be certified by a State or local government subject to conditions specified by the Secretary of the Interior.

The credit may be claimed in one of three ways. First, if the taxpayer directly incurs the qualifying expenditures in rehabilitation of his or her principal residence, the taxpayer may claim the tax credit on his or her return.

Second, the taxpayer may claim the credit on his or her return if the taxpayer is the first purchaser of a structure on which qualified rehabilitation expenditures have been made.

Third, the taxpayer may elect to receive an historic rehabilitation mortgage credit certificate. An historic rehabilitation mortgage credit certificate is a certificate stating the value of the credit that would be allowable to the taxpayer for qualified historic rehabilitation expenditures. The taxpayer may transfer the historic rehabilitation mortgage credit certificate to a lending institution in connection with a loan that is to be secured by the structure on which the qualified rehabilitation expenditures were incurred. In exchange for the rehabilitation mortgage credit certificate, the lending institution provides the taxpayer with a loan, the rate of interest on which is less than that for which the taxpayer otherwise would have qualified.

In the case of structures located in empowerment zones, in enterprise communities, in a census tract in which 70 percent of families have income which is 80 percent or less of the State median family income, and areas of chronic distress as designated by the State and approved by the Secretary of Housing and Urban Development, the taxpayer may elect that the loan be satisfied by principal payments less than those that would otherwise be required such that the present value of the reduced principal payments over

the term of the loan be substantially equivalent to the value stated on the historic rehabilitation mortgage credit certificate.

The lending institution that enters into the exchange with the taxpayer may claim the credit amount against its regular income tax liability. Reductions in interest payments and reductions in principal payments resulting from a qualified exchange of a rehabilitation mortgage credit certificate would not be taxable income to the taxpayer.

If a taxpayer ceases to maintain the structure as his or her personal residence within five years from the date of the rehabilitation, the credit is recaptured on a pro rata basis. In the case of a taxpayer who elected to receive and exchange a rehabilitation mortgage credit certificate with a lending institution, any recapture liability would be paid by the taxpayer.

Effective date.—The provision is effective for expenditures paid or incurred beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment, but modifies the provision to provide a tax deduction for qualified expenses incurred by a homeowner who makes renovations to his or her principal residence. Thus, the conference agreement provides that a taxpayer may claim a deduction for 50 percent of qualified rehabilitation expenditures made with respect to a qualified historic home which the taxpayer subsequently occupies as his or her principal residence for at least five years. The total amount of deduction which could be claimed by the taxpayer is limited to $50,000 ($25,000 in the case of married taxpayer filing a separate return) with respect to any qualified historic home. The deduction is to be treated as a miscellaneous itemized deduction, subject to the present-law two-percent floor on miscellaneous deductions. For taxpayers subject to the alternative minimum tax, the deduction for qualified expenditures may be claimed against the taxpayer's alternative minimum taxable income.

The conference agreement follows the Senate amendment with respect to the definitions of qualifying structures and qualifying expenditures, and regarding certification requirements.

If a taxpayer ceases to maintain the structure as his or her personal residence within five years from the date of the rehabilitation, the deduction is recaptured, on a pro rata basis, as taxable income to the taxpayer.

Effective date.—The provision is effective for expenditures paid or incurred beginning after December 31, 1999.

G. Accelerate the Scheduled Increase in State Volume Limits on Tax-Exempt Private Activity Bonds (sec. 1351 of the House bill, sec. 1081 of the Senate amendment 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 (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 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).

The current annual volume limits that apply to private activity tax-exempt bonds increase to $75 per resident of each State or $225 million, if greater, beginning in calendar year 2007. The increase is, ratably phased in, beginning with $55 per capita or $165 million, if greater, in calendar year 2003.

House Bill

The House bill increases the present-law annual State private activity bond volume limits to $75 per resident of each State or $225 million (if greater).

Effective date.—The House bill volume limit increases are effective for calender years after December 31, 1999.

Senate Amendment

The Senate amendment increases the present-law annual State private activity bond volume limits to $75 per resident of each State or $225 million (if greater) beginning in calendar year 2005. The increase is phased-in as follows, beginning in calendar year 2001:

Calendar year	Volume limit
2001	$55 per resident ($165 million if greater).
2002	$60 per resident ($180 million if greater).
2003	$65 per resident ($195 million if greater).
2004	$70 per resident ($210 million if greater).

Effective date.—The Senate amendment volume limit increases are effective beginning in calendar year 2001 and will be fully effective in calendar year 2005 and thereafter.

Conference Agreement

The conference agreement increases the present-law annual State private activity bond volume limits to $75 per resident of each State or $225 million (if greater) beginning in calendar year 2004. The increase is phased-in as follows, beginning in calendar year 2000:

Calendar year	Volume limit
2000	$55 per resident ($165 million if greater).
2001	$60 per resident ($180 million if greater).
2002	$65 per resident ($195 million if greater).
2003	$70 per resident ($210 million if greater).

Effective date.—The provision is effective beginning in calendar year 2000 and will be fully effective in calendar year 2004 and thereafter.

H. Treatment of Leasehold Improvements (sec. 1091 of the Senate amendment and sec. 168 of the Code)

Present Law

Depreciation of leasehold improvements

Depreciation allowances for property used in a trade or business generally are determined under the modified Accelerated Cost Recovery System ("MACRS") of section 168. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the MACRS recovery period assigned to the property is longer than the term of the lease (sec. 168(i)(8)).[100] This rule applies regardless whether the lessor or lessee places the leasehold improvements in service.[101] If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement is depreciated using the straight-line method over a 39–year recovery period, beginning in the month the addition or improvement was placed in service (secs. 168(b)(3), (c)(1), (d)(2), and (i)(6)).[102]

Treatment of dispositions of leasehold improvements

A lessor of leased property that disposes of a leasehold improvement which was made by the lessor for the lessee of the property may take the adjusted basis of the improvement into account

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

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

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

for purposes of determining gain or loss if the improvement is irrevocably disposed of or abandoned by the lessor at the termination of the lease.[103] This rule conforms the treatment of lessors and lessees with respect to leasehold improvements disposed of at the end of a term of lease. For purposes of applying this rule, it is expected that a lessor must be able to separately account for the adjusted basis of the leasehold improvement that is irrevocably disposed of or abandoned. This rule does not apply to the extent section 280B applies to the demolition of a structure, a portion of which may include leasehold improvements.[104]

House Bill

No provision.

Senate Amendment

The provision provides that 15-year property for purposes of the depreciation rules of section 168 includes qualified leasehold improvement property. The straight line method is required to be used with respect to qualified leasehold improvement property.

Qualified leasehold improvement property is any improvement to an interior portion of a building that is nonresidential real property, provided certain requirements are met. The improvement must be made under or pursuant to a lease either by the lessee (or sublessee) of that portion of the building, or by the lessor of that portion of the building. That portion of the building is to be occupied exclusively by the lessee (or any sublessee). The original use of the qualified leasehold improvement property must begin with the lessee, and must begin after December 31, 2002.[105] The improvement must be placed in service more than three years after the date the building was first placed in service.

Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefitting a common area, or the internal structural framework of the building.

No special rule is specified for the class life of qualified leasehold improvement property. Therefore, the general rule that the class life for nonresidential real and residential rental property is 40 years applies.

For purposes of the provision, a commitment to enter into a lease is treated as a lease, and the parties to the commitment are treated as lessor and lessee, provided the lease is in effect at the time the qualified leasehold improvement property is placed in service. A lease between related persons is not considered a lease for this purpose.

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[103] The conference report describing this provision mistakenly states that the provision applies to improvements that are irrevocably disposed of or abandoned by the lessee (rather than the lessor) at the termination of the lease.

[104] Under present law, section 280B denies a deduction for any loss sustained on the demolition of any structure.

[105] The Finance Committee report describing the provision erroneously states that this date is December 31, 2000.

Effective date.—The provision is effective for qualified leasehold improvement property placed in service after December 31, 2002.

Conference Agreement

The conference agreement does not include the Senate amendment provision. However, the conferees expect that the depreciation study (pursuant to section 2022 of the Tax and Trade Relief Extension Act of 1998) will include an examination of the depreciation issues raised in the House bill and the Senate amendment, including leasehold improvements and section 1250 property used in connection with a franchise.

XII. PENSION REFORM PROVISIONS

A. Expanding Coverage

1. Increase in benefit and contribution limits (sec. 1201 of the House bill, sec. 312 of the Senate amendment, and secs. 401(a)(17), 402(g), 408(p), 415 and 457 of the Code)

Present Law

In general

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415), the amount of compensation that may be taken into account under a plan for determining benefits (sec. 401(a)(17)), the maximum amount of elective deferrals that an individual may make to a salary reduction plan or tax sheltered annuity (sec. 402(g)), and deferrals under an eligible deferred compensation plan of a tax-exempt organization or a State or local government (sec. 457).

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) $30,000 (for 1999). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $30,000 limit is indexed for cost-of-living adjustments in $5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $130,000 (for 1999). The dollar limit is adjusted for cost-of-living increases in $5,000 increments.

Under present law, in general, the dollar limit on annual benefits is reduced if benefits under the plan begin before the social security retirement age (currently, age 65) and increased if benefits begin after social security retirement age.[106]

[106] An overall limit applies if a participant participates in a defined contribution plan and a defined benefit plan maintained by the same employer (sec. 415(e)). This limit is repealed for years beginning after December 31, 1999.

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $160,000 (for 1999). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,000 (for 1999). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 1999) or (2) 33⅓ percent of compensation. The $8,000 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

House Bill

Limits on contributions and benefits

The House bill increases the $30,000 annual addition limit for defined contribution plans to $40,000. This amount is indexed in $1,000 increments.[107]

The House bill increases the $130,000 annual benefit limit under a defined benefit plan to $160,000. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The House bill increases the limit on compensation that may be taken into account under a plan to $200,000. This amount is indexed in $5,000 increments.

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[107] The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the House bill.

Elective deferral limitations

Beginning in 2001, the House bill increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs in $1,000 annual increments until the limits reach $15,000 in 2005. Beginning in 2001, the House bill increases the maximum annual elective deferrals that may be made to a SIMPLE plan in $1,000 annual increments until the limit reaches $10,000 in 2004. The $15,000 and $10,000 dollar limits are indexed in $500 increments, as under present law.

Section 457 plans

The House bill increases the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit is $11,000 in 2001, and is increased in $1,000 annual increments until the limit reaches $15,000 in 2005. The limit is indexed thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[108]

Effective date

The House bill is effective for years beginning after December 31, 2000, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement.

Senate Amendment

Beginning in 2001, the Senate amendment increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs in $1,000 annual increments until the limits reach $15,000 in 2005. Beginning in 2001, the Senate amendment increases the maximum annual elective deferrals that may be made to a SIMPLE plan in $1,000 annual increments until the limit reaches $10,000 in 2004. The $15,000 and $10,000 dollar limits are indexed in $500 increments, as under present law.

The Senate amendment increases the dollar limit on deferrals under a section 457 plan to $9,000 in 2001, $10,000 in 2002, $11,000 in 2003, and $12,000 in 2004. The limit is indexed thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[109]

Effective date.—The Senate amendment is effective for years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the House bill.

Effective date.—The conference agreement is effective for years beginning after December 31, 2000.

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[108] Another provision of the bill increases the 33–1/3 percentage of compensation limit to 100 percent.

[109] Another provision of the Senate amendment increases the 33–1/3 percentage of compensation limit to 100 percent.

2. Plan loans for subchapter S shareholders, partners, and sole proprietors (sec. 1202 of the House bill, sec. 313 of the Senate amendment and sec. 4975 of the Code)

Present Law

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of plan participants and beneficiaries.[110] Certain types of transactions are exempted from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Department of Labor can grant an administrative exemption from the prohibited transaction rules if she finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan.

For purposes of the prohibited transaction rules, an owner-employee means (1) a sole proprietor, (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership, (3) an employee or officer of a Subchapter S corporation who owns more than 5 percent of the outstanding stock of the corporation, and (4) the owner of an individual retirement arrangement ("IRA"). The term owner-employee also includes certain family members of an owner-employee and certain corporations owned by an owner-employee.

Under the Internal Revenue Code, a two-tier excise tax is imposed on disqualified persons who engage in a prohibited transaction. The first level tax is equal to 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period, and is equal to 100 percent of the amount involved.

House Bill

The House bill generally eliminates the special present-law rules relating to plan loans made to an owner-employee. Thus, the general statutory exemption applies to such transactions. Present law continues to apply with respect to IRAs.

Effective date.—The House bill is effective with respect to loans made after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.[111]

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

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[110] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

[111] The Senate amendment also amends the corresponding provisions of ERISA.

3. Modification of top-heavy rules (sec. 1203 of the House bill, sec. 319 of the Senate amendment, and sec. 416 of the Code)

Present Law

In general

Under present law, additional qualification requirements apply to plans that primarily benefit an employer's key employees ("top-heavy plans"). These additional requirements provide (1) more rapid vesting for plan participants who are non-key employers and (2) minimum nonintegrated employer contributions or benefits for plan participants who are non-key employees.

Definition of top-heavy plan

In general, a top-heavy plan is a plan under which more than 60 percent of the contributions or benefits are provided to key employees.

For purposes of determining whether a plan is a top-heavy plan, benefits derived both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the 5-year period ending on the determination date.

An individual's accrued benefit or account balance is not taken into account in determining whether a plan is top-heavy if the individual has not performed services for the employer during the 5-year period ending on the determination date.

SIMPLE plans are not subject to the top-heavy rules.

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the 4 preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 ($65,000 for 1999), (2) a 5–percent owner of the employer, (3) a 1-percent owner of the employer earning over $150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit ($30,000 for 1999) with the largest ownership interests in the employer. A family ownership attribution rule applies to the determination of 1-percent owner status, 5-percent owner status, and largest ownership interest. Under this attribution rule, an individual is treated as owning stock owned by the individual's spouse, children, grandchildren, or parents.

Minimum benefit for non-key employees

A minimum benefit generally must be provided to all non-key employees in a top-heavy plan. In general, a top-heavy defined benefit plan must provide a minimum benefit equal to the lesser of (1) 2 percent of compensation multiplied by the employee's years of service, or (2) 20 percent of compensation. A top-heavy defined contribution plan must provide a minimum annual contribution equal to the lesser of (1) 3 percent of compensation, or (2) the percentage

of compensation at which contributions were made for key employees (including employee elective contributions made by key employees and employer matching contributions).

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401(k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4).[112]

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test). Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

Under a design-based safe harbor, a cash or deferred arrangement is deemed to satisfy the ADP test if the plan satisfies one of two contribution requirements and satisfies a notice requirement.

House Bill

Definition of top-heavy plan

The House bill provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan may be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[113]

In determining whether a plan is top-heavy, the House bill provides that distributions during the year ending on the date the top-heavy determination is being made are taken into account. The present-law 5-year rule applies with respect to in-service distributions. Similarly, the House bill provides that an individual's accrued benefit or account balance is not taken into account if the in-

[112] Tres. Reg. sec. 1.416–1 Q&A M–19.

[113] This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

dividual has not performed services for the employer during the 1-year period ending on the date the top-heavy determination is being made.

Definition of key employee

The House bill (1) provides that an employee is not considered a key employee by reason of officer status unless the employee earns more than $150,000 in compensation for the year, and (2) repeals the top-10 owner key employee category.

The House bill repeals the 4-year lookback rule for determining key employee status and provides that an employee is a key employee only if he or she is a key employee during the current plan year.

Minimum benefit for non-key employees

Under the House bill, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.[114]

The House bill provides that, in determining the minimum benefit required under a defined benefit plan, a year of service does not include any year in which no employee benefits under the plan (as determined under sec. 410).

Effective date

The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

Definition of top-heavy plan

The Senate amendment provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan may be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[115]

Definition of key employee

The family ownership attribution rule no longer applies in determining whether an individual is a 5-percent owner of the employer for purposes of the top-heavy rules only.

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[114] Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

[115] This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

Minimum benefit for non-key employees

Under the provision, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.[116]

Effective date

The Senate amendment provision is effective for years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment. As under the Senate amendment, the family ownership attribution rule no longer applies in determining whether an individual is a 5-percent owner of the employer for purposes of the top-heavy rules only.

4. Elective deferrals not taken into account for purposes of deduction limits (sec. 1204 of the House bill, sec. 314 of the Senate amendment, and sec. 404 of the Code)

Present Law

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

For purposes of the deduction limits, employee elective deferral contributions to a section 401(k) plan are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.

Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

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[116] Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minium benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

House Bill

Under the House bill, elective deferral contributions are not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account elective deferral contributions.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations (sec. 1205 of the House bill and sec. 457 of the Code)

Present Law

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 1999) or (2) 33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments.

The $8,000 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the $8,000 limit, contributions under a tax-sheltered annuity ("section 403(b) annuity"), elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), salary reduction contributions under a simplified employee pension plan ("SEP"), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

House Bill

The House bill repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.[117]

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

No provision.

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[117] The limits on deferrals under a section 457 plan are modified under other provisions of the House bill.

Conference Agreement

The conference agreement follows the House bill.

6. Eliminate IRS user fees for certain requests regarding employer plans (sec. 1206 of the House bill, sec. 317 of the Senate amendment, and sec. 7527 of the Code)

Present Law

An employer that maintains a retirement plan for the benefit of its employees may request from the Internal Revenue Service ("IRS") a determination as to whether the form of the plan satisfies the requirements applicable to tax-qualified plans (sec. 401(a)). In order to obtain from the IRS a determination letter on the qualified status of the plan, the employer must pay a user fee. The user fee may range from $125 to $1,250, depending upon the scope of the request and the type and format of the plan.[118]

House Bill

Under the House bill, a small employer (100 or fewer employees) is not required to pay a user fee for any determination letter request with respect to the qualified status of a retirement plan that the employer maintains. The House bill applies only to requests by employers for determination letters concerning the qualified retirement plans they maintain. Therefore, a sponsor of a prototype plan is required to pay a user fee for a request for a notification letter, opinion letter, or similar ruling. A small employer that adopts a prototype plan, however, is not required to pay a user fee for a determination letter request with respect to the employer's plan.

Effective date.—The House bill is effective for determination letter requests made after December 31, 2000.

Senate Amendment

The Senate amendment provides that no user fee may be required with respect to a request for a ruling, opinion letter, determination letter, or similar request regarding the qualified status of a new pension plan. A new pension plan would be a plan of an employer which has not maintained a qualified plan in the three most recent years ending before the year in which the request is made.

Conference Agreement

The conference agreement follows the House bill, with the modification that the user fee is eliminated only for determination letter requests made during the first 5 plan years of the plan.

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[118] User fees are statutorily authorized; however, the IRS sets the dollar amount of the fee applicable to any particular type of request.

7. Definition of compensation for purposes of deduction limits (sec. 1207 of the House bill and sec. 404 of the Code)

Present Law

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In some cases, the amount of deductible contributions is limited by compensation. In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

In the case of an employee stock ownership plan ("ESOP"), principal payments on a loan used to acquire qualifying employer securities are deductible up to 25 percent of compensation.

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement ("section 401(k) plan") are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.[119]

For purposes of the deduction rules, compensation generally includes only taxable compensation, and thus does not include salary reduction amounts, such as elective deferrals under a section 401(k) plan or a tax-sheltered annuity ("section 403(b) annuity"), elective contributions under a deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan"), and salary reduction contributions under a section 125 cafeteria plan. For purposes of the contribution limits under section 415, compensation does include such salary reduction amounts.

[119] Another provision in the House bill provides that elective deferrals are not subject to the deduction limits.

House Bill

Under the House bill, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415.[120]

Effective date.—The House bill provision is effective for years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

8. Option to treat elective deferrals as after-tax contributions (sec. 1208 of the House bill, sec. 311 of the Senate amendment, and new sec. 402A of the Code)

Present Law

A qualified cash or deferred arrangement ("section 401(k) plan") or a tax-sheltered annuity ("section 403(b) annuity") may permit a participant to elect to have the employer make payments as contributions to the plan or to the participant directly in cash. Contributions made to the plan at the election of a participant are elective deferrals. Elective deferrals must be nonforfeitable and are subject to an annual dollar limitation (sec. 402(g)) and distribution restrictions. In addition, elective deferrals under a section 401(k) plan are subject to special nondiscrimination rules. Elective deferrals (and earnings attributable thereto) are not includible in a participant's gross income until distributed from the plan.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into a Roth IRA. Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to $10,000). A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).[121]

House Bill

A section 401(k) plan or a section 403(b) annuity is permitted to include a "qualified plus contribution program" that permits a

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[120] A technical correction in the House bill expands the salary reduction amounts treated as compensation under section 415 to include amounts used to purchase qualified transportation benefits (under sec. 132(f)).

[121] Early distributions of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions. Designated plus contributions are elective deferrals that the participant designates as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated plus contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions are treated as any other elective deferral for purposes of nonforfeitability requirements and distribution restrictions. Under a section 401(k) plan, designated plus contributions also are treated as any other elective deferral for purposes of the special nondiscrimination requirements.

The plan is required to establish a separate account, and maintain separate recordkeeping, for a participant's designated plus contributions (and earnings allocable thereto). A qualified distribution from a participant's designated plus contributions account is not includible in the participant's gross income. A qualified distribution is a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.[122] The nonexclusion period is the 5-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account.

A distribution from a designated plus contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals is not a qualified distribution.

A participant is permitted to roll over a distribution from a designated plus contributions account only to another designated plus contributions account or a Roth IRA of the participant.

The Secretary of the Treasury is directed to require the plan administrator of each section 401(k) plan or section 403(b) annuity that permits participants to make designated plus contributions to make such returns and reports regarding designated plus contributions to the Secretary, plan participants and beneficiaries, and other persons that the Secretary may designate.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2000.

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[122] A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated plus contributions account.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

9. Increase minimum benefit under defined benefit plans (sec. 1209 of the House bill and sec. 415 of the Code)

Present Law

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of the participant's compensation, or (2) $130,000 (for 1999).[123] Payment of a minimum annual benefit is permitted even if the benefit exceeds the normally applicable benefit limitations. Thus, the limits on benefits are deemed to be satisfied if the aggregate annual retirement benefit of a participant under all defined benefit pension plans of the employer does not exceed $10,000 and the participant has not participated in a defined contribution plan of the employer. The $10,000 limit is reduced for participants with less than 10 years of service with the employer.

House Bill

Under the House bill, beginning in 2001, the minimum annual benefit permitted under a defined benefit plan is increased in $10,000 annual increments until the minimum benefit amount reaches $40,000 in 2003. The $40,000 amount is not indexed. In addition, a participant is entitled to the minimum benefit even if the participant had participated in a defined contribution plan of the employer.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

10. Reduced PBGC premiums for small and new plans (secs. 315–316 of the Senate amendment and sec. 4006 of ERISA)

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaran-

[123] Another provision of the House bill increases the dollar limit on the annual benefit payable under a defined benefit plan.

teeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than 5 years, and with respect to benefit increases from a plan amendment that was in effect for less than 5 years before termination of the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

House Bill

No provision.

Senate Amendment

Reduced flat-rate premiums for new plans of small employers

Under the Senate amendment, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium is $5 per plan participant.

A small employer is a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

Reduced variable PBGC premium for new plans

The Senate amendment provides that the variable premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable premium is a percentage of the variable premium otherwise due, as follows: 0 percent of the otherwise applicable variable premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as under the flat-rate premium provision relating to new small employer plans.

Effective date

The Senate amendment provisions are effective for plans established after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment, with a modification. In the case of any plan (not just a new plan) of an employer with 25 or fewer employees, the variable-rate premium is no more than $5 multiplied by the number of plan participants in the plan at the close of the preceding year.

Effective date.—The provision is generally effective for plans established after December 31, 2000. The provision regarding plans of employers with 25 or fewer employees is effective for plan years beginning after December 31, 2000.

11. SAFE annuities and trusts (sec. 318 of the Senate amendment and new sec. 408B of the Code)

Present Law

A small business may establish a simplified defined contribution retirement plan called a savings incentive match plan for employees ("SIMPLE") retirement plan. An employer is eligible to adopt a SIMPLE plan if the employer employs 100 or fewer employees who received at least $5,000 in compensation during the preceding year and does not maintain another retirement plan.

A SIMPLE plan may be either an individual retirement arrangement for each employee ("SIMPLE IRA") or part of a qualified cash or deferred arrangement (a "SIMPLE 401(k)"). A SIMPLE IRA is not subject to the nondiscrimination rules or top-heavy rules generally applicable to qualified plans. Similarly, a SIMPLE 401(k) is deemed to satisfy the special nondiscrimination tests applicable to 401(k) plans and is not subject to the top-heavy rules. The other qualified plan rules apply to a SIMPLE 401(k), however.

SIMPLE plans are subject to special contribution rules. Employees may elect during the 60-day period preceding a plan year to make elective contributions under a SIMPLE plan of up to $6,000 during the plan year. The $6,000 dollar limit is adjusted for cost-of-living increases in $500 increments.

An employer that maintains a SIMPLE plan generally is required to match each employee's elective contributions on a dollar-for-dollar basis up to 3 percent of the employee's compensation. As an alternative to a matching contribution for any year, an employer may make a nonelective contribution on behalf of each eligible employee equal to 2 percent of the employee's compensation.

Under a SIMPLE IRA, the compensation limit does not apply for purposes of the required employer matching contribution. If the employer satisfies the contribution requirement by making a nonelective contribution, however, the amount of compensation taken into account for each participant to determine the amount of the required employer contribution may not exceed the compensation limit.

Under a SIMPLE 401(k), the compensation limit applies for purposes of the matching contribution as well as the nonelective contribution.

No contributions other than employee elective contributions and required employer contributions may be made to a SIMPLE plan. All contributions under a SIMPLE plan must be fully vested.

Present law does not provide for a simplified defined benefit plan similar to the SIMPLE plan.

House Bill

No provision.

Senate Amendment

Under the Senate amendment, a small business may establish a simplified retirement plan called the secure assets for employees ("SAFE") plan. The SAFE plan combines the features of a defined benefit plan and a defined contribution plan.

Employer and employee eligibility and vesting

An employer is eligible to adopt a SAFE plan if the employer employs 100 or fewer employees who received at least $5,000 in compensation during the preceding year and does not maintain another retirement plan other than a plan that provides only for elective deferrals or matching contributions, an eligible deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan"), or a collectively bargained plan.

Each employee whose compensation was at least $5,000 in any 2 preceding consecutive years and in the current year generally is eligible to participate. All benefits under a SAFE plan are fully vested at all times.

Benefits and funding

A SAFE plan provides a fully funded minimum defined benefit. For each year of participation, a participant generally accrues a minimum annual benefit at retirement equal to 3 percent of the participant's compensation for the year. The employer may elect to provide a benefit of 2 percent, 1 percent, or 0 percent of compensation for any year for all participants if the employer notifies the participants of such lower percentage within a reasonable period before the beginning of the year. Benefits under a SAFE plan are subject to the annual limitation on compensation that may be taken into account under a qualified plan ($160,000 in 1999).

An employer may count up to 10 years of service performed by a participant before the adoption of a SAFE plan ("prior service year") if the same number of prior service years is available to all employees eligible to participate in the SAFE plan for the first plan year. Prior service years is taken into account by doubling the amount of the contribution the employer would otherwise make for each participant with prior service years, beginning with the first year the SAFE plan is in effect. A participant's prior service years do not include any years in which a participant was an active participant in any defined benefit plan maintained by the employer or received less than $5,000 in compensation from the employer.

Each year the employer is required to contribute to the SAFE plan on behalf of each participant an amount sufficient to provide the annual benefit accrued for the year payable at age 65, using specified actuarial assumptions (including an interest rate not less than 3 percent and not greater than 5 percent per year). A SAFE plan may be funded either through an individual retirement annu-

ity for each employee ("SAFE Annuity") or through a trust (a "SAFE Trust").

Under a SAFE Trust, each participant has an account to which actual investment returns are credited. If a participant's account balance is less than the total of past employer contributions credited with a specified interest rate (not less than 3 percent and not greater than 5 percent per year), the employer is required to make up the shortfall. If the investment returns in a participant's account exceed the specified interest rate, the participant is entitled to the larger account balance. Permissible investments of a SAFE Trust are securities that are readily tradable on an established securities market and insurance company products that are regulated by State law.

Under a SAFE Annuity, each year the employer is required to contribute the amount necessary to purchase an annuity that provides the benefit accrual for the year.

The required contributions to a SAFE plan are deductible under the rules applicable to qualified defined benefit plans. An excise tax applies if the employer fails to make the required contribution for the year.

Benefits under a SAFE plan are not guaranteed by the Pension Benefit Guaranty Corporation.

Distributions

A SAFE plan may provide for distributions at any time. Distributions from a SAFE plan are subject to tax under the present-law rules applicable to distributions from qualified plans, except that a distribution prior to the participant's attainment of age 59½ generally are subject to an additional tax equal to 20 percent of the amount distributed.

A SAFE plan must provide for payment of benefits in the form of a single life annuity payable at age 65 or any actuarially equivalent form of benefit. A SAFE plan is not subject to the joint and survivor annuity requirements applicable to other defined benefit pension plans.

Nondiscrimination requirements and other rules

A SAFE plan is not subject to the nondiscrimination rules, the top-heavy plan rules, or the limitations on benefits or contributions applicable to qualified retirement plans. A SAFE plan is subject to the qualified plan requirement that a participant's benefit accrual may not cease merely because the participant has attained a specified age (sec. 411(b)(1)(H)). Simplified reporting and disclosure requirements apply to SAFE plans.

Effective date

The Senate amendment provision is effective for years beginning after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment.

B. Enhancing Fairness for Women

1. Additional catch-up contributions (sec. 1221 of the House bill, sec. 321 of the Senate amendment, and secs. 219, 402(g), 408(p), and 457 of the Code)

Present Law

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,000 (for 1999). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,000. These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,000 (for 1999) or (2) 33⅓ percent of compensation. The $8,000 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last 3 years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

IRAs

Under present law, the maximum annual contribution that can be made to all an individuals IRAs is the lesser of $2,000 or the individual's compensation for the year. Special rules apply in the case of a married couple to allow up to the maximum contribution for each spouse, provided that the combined compensation of the spouses is at least equal to the total IRA contributions.

House Bill

The House bill provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, or SIMPLE, or deferrals under a section 457 plan are increased for individuals who have attained age 50 by the end of the year.[124] The otherwise applicable dollar limit is increased by $1,000 in each year beginning in 2001 until the amount of the increase is $5,000 in 2005. Thereafter, the $5,000 limit is indexed for inflation in $500 increments. In the case of section 457 plans, this

[124] Another provision in the House bill increases the dollar limit on elective deferrals under such arrangements.

catch-up rule does not apply during the participant's last 3 years before retirement (in those years, the regularly applicable dollar limit is doubled).

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

The Senate amendment provides that individuals who have attained age 50 may make additional catch-up elective contributions to employer-sponsored retirement plans and additional catch-up IRA contributions.

In the case of employer-sponsored retirement plans, the provision applies to elective deferrals under a section 401(k) plan, section 403(b) annuity, SIMPLE, or section 457 plan. Additional contributions may be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the provision, the additional amount of elective contributions that may be made by an eligible individual participating in such a plan is the lesser of (1) the applicable percent of the maximum dollar amount of elective deferrals otherwise excludable from the gross income of the participant for the year (under sec. 402(g)) or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.[125] The applicable percent is 10 percent in 2001, and increases by 10 percentage points until the applicable percent is 50 in 2005 and thereafter.

Catch-up contributions made under the provision are not subject to any other contribution limits and are not taken into account in applying other contribution limits. In addition, such contributions are not subject to applicable nondiscrimination rules.[126]

An employer may make matching contributions with respect to catch-up contributions. Any such matching contributions are subject to the normally applicable rules.[127]

Effective date.—The Senate amendment is effective for years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

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[125] In the case of a section 457 plans, this catch-up rule does not apply during the participant's last 3 years before retirement (in those years, the regularly applicable dollar limit is doubled).

[126] Another provision in the Senate amendment provides that elective contributions are deductible without regard to the otherwise applicable deduction limits.

[127] The Senate amendment contains a similar catch-up rule for IRAs, described earlier.

2. Equitable treatment for contributions of employees to defined contribution plans (sec. 1222 of the House bill, sec. 322 of the Senate amendment, and secs. 403(b), 415, and 457 of the Code)

Present Law

Present law imposes limits on the contributions that may be made to tax-favored retirement plans.

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of $30,000 (for 1999) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions. A separate limit applies to benefits under a defined benefit plan.

For years beginning before January 1, 2000, an overall limit applies if an employee is a participant in both a defined contribution plan and a defined benefit plan of the same employer.

Tax-sheltered annuities

In the case of a tax-sheltered annuity (a "section 403(b) annuity"), the annual contribution generally cannot exceed the lesser of the exclusion allowance or the section 415(c) defined contribution limit. The exclusion allowance for a year is equal to 20 percent of the employee's includible compensation, multiplied by the employee's years of service, minus excludable contributions for prior years under qualified plans, tax-sheltered annuities or section 457 plans of the employer.

For purposes of determining the contribution limits applicable to section 403(b) annuities, includible compensation means the amount of compensation received from the employer for the most recent period which may be counted as a year of service under the exclusion allowance. In addition, includible compensation includes elective deferrals and similar salary reduction amounts.

Treasury regulations include provisions regarding application of the exclusion allowance in cases where the employee participates in a section 403(b) annuity and a defined benefit plan. The Taxpayer Relief Act of 1997 directed the Secretary of the Treasury to revise these regulations, effective for years beginning after December 31, 1999, to reflect the repeal of the overall limit on contributions and benefits.

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,000 (in 1999) or (2)

33⅓ percent of compensation. The $8,000 limit is increased for inflation in $500 increments.

House Bill

Increase in defined contribution plan limit

The House bill increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 100 percent.[128]

Conforming limits on tax-sheltered annuities

The House bill repeals the exclusion allowance applicable to contributions to tax-sheltered annuities. Thus, such annuities are subject to the limits applicable to tax-qualified plans.

Section 457 plans

The House bill increases the 33⅓ percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation.

Effective date

The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with a modification. The conference agreement directs the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. For taxable years beginning after December 31, 1999, the regulatory provisions regarding the exclusion allowance are to be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void.

Effective date.—The provisions are generally effective for years beginning after December 31, 2000. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment.

3. Faster vesting of employer matching contributions (sec. 1223 of the bill, sec. 325 of the Senate amendment, and sec. 411 of the Code)

Present Law

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as

[128] Another provision of the House bill increases the defined contribution plan dollar limit.

under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of 5 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after 3 years of service, 40 percent after 4 years of service, 60 percent after 5 years of service, 80 percent after 6 years of service, and 100 percent after 7 years of service.[129]

House Bill

Under the House bill, employer matching contributions have to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of 3 years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after 6 years of service.

Effective date.—The provision is effective for plan years beginning after December 31, 2000, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The provision does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date is taken into account.

Senate Amendment

The Senate amendment is the same as the House bill.[130]

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

4. Simplify and update the minimum distribution rules (secs. 1224 and 1239 of the House bill and secs. 401(a)(9) and 457 of the Code)

Present Law

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum

[129] The minimum vesting requirements are also contained in title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

[130] The Senate amendment makes corresponding changes to title I of ERISA.

benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax can be waived if the individual establishes to the satisfaction of the Secretary that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a 5-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the 5-percent owner attains age 70½. If commencement of benefits is delayed beyond age 70½ from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan.[131] In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 following the calendar year in which the IRA owner attains age 70½. The pre-death minimum distribution rules do not apply to Roth IRAs.

In general, under proposed regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in period payments made at intervals not longer than one year over a permissible period, and must be nonincreasing, or increase only as a result of the following: (1) cost-of-living adjustments; (2) cash refunds of employee contributions; (3) benefit increases under the plan; or (4) an adjustment due to death of the employee's beneficiary. In the case of a defined contribution plan, the minimum required distribution is determined by dividing the employee's benefit by the applicable life expectancy.

[131] State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70½

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if the participant dies after minimum distributions have begun, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death. If the participant dies before minimum distributions have begun, then the entire remaining interest must generally be distributed within 5 years of the participant's death. The 5-year rule does not apply if distributions begin within 1 year of the participant's death and are payable over the life expectancy of a designated beneficiary. A surviving spouse beneficiary is not required to begin distribution until the date the deceased participant would have attained age 70½.

Special rules for section 457 plans

Eligible deferred compensation plans of State and local and tax-exempt employers ("section 457 plans") are subject to the minimum distribution rules described above. Such plans are also subject to additional minimum distribution requirements (sec. 457(d)(2)(b)).

House Bill

Modification of post-death distribution rules

The House bill applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest must be made within 5 years of the date of death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions are not required to begin until the surviving spouse attains age 70½. Minimum distributions that have already begun may be recalculated under the new rule.

Reduction in excise tax

The House bill reduces the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed.

Treasury regulations

The Treasury is directed to update, simplify and finalize the regulations relating to the minimum distribution rules. The Treasury is directed to reflect in the regulations current life expectancies and to revise the required distribution methods so that, under reasonable assumptions, the amount of the required distribution does not decrease over time. The regulations are to permit recalculation of distributions for future years to reflect the change in the regulations, and to permit the election of a new designated beneficiary and method of calculating life expectancy. The regulations are effective for years beginning after December 31, 2000.

Section 457 plans

The House bill repeals the special minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the same minimum distribution rules applicable to other types of tax-favored arrangements.

Effective date

In general, the provision is effective for years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

5. Clarification of tax treatment of division of section 457 plan benefits upon divorce (sec. 1225 of the House bill, sec. 323 of the Senate amendment, and sec. 457 of the Code)

Present Law

Under present law, benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances. One exception to the prohibition on assignment or alienation rule is a qualified domestic relations order ("QDRO"). A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant, and that meets certain procedural requirements.

Under present law, a distribution from a governmental plan or a church plan is treated as made pursuant to a QDRO if it is made pursuant to a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant. Such distributions are not required to meet the procedural requirements that apply with respect to distributions from qualified plans.

Under present law, amounts distributed from a qualified plan generally are taxable to the participant in the year of distribution. However, if amounts are distributed to the spouse (or former spouse) of the participant by reason of a QDRO, the benefits are taxable to the spouse (or former spouse). Amounts distributed pursuant to a QDRO to an alternate payee other than the spouse (or former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or State and local government employer. The QDRO rules do not apply to section 457 plans.

House Bill

The House bill applies the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. In addition, a section 457 plan is not treated as violating the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. The special rule applicable to governmental plans and church plans applies for purposes of determining whether a distribution is pursuant to a QDRO.

Effective date.—The provision is effective for transfers, distributions and payments made after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

6. Modification of safe harbor relief for hardship withdrawals from 401(k) plans (sec. 324 of the Senate amendment)

Present Law

Elective deferrals under a qualified cash or deferred arrangement (a "section 401(k) plan") may not be distributable prior to the occurrence of one or more specified events. One event upon which distribution is permitted is the financial hardship of the employee. Applicable Treasury regulations[132] provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.

The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution.

House Bill

No provision.

Senate Amendment

The Secretary of the Treasury is directed to revise the applicable regulations to reduce from 12 months to 6 months the period during which an employee must be prohibited from making elective contributions and employee contributions in order for a distribution to be deemed necessary to satisfy an immediate and heavy financial need.

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[132] Treas. Reg. sec. 1.401(k)–1.

Effective date.—The Senate amendment provision is effective for years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

C. Increasing Portability for Participants

1. Rollovers of retirement plan and IRA distributions (secs. 1231–1233 and 1239 of the House bill, secs. 331–333 and 339 of the Senate amendment, and secs. 401, 402, 403(b), 408, 457, and 3405 of the Code)

Present Law

In general

Present law permits the rollover of funds from a tax-favored retirement plan to another tax-favored retirement plan. The rules that apply depend on the type of plan involved. Similarly, the rules regarding the tax treatment of amounts that are not rolled over depend on the type of plan involved.

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer-sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA")[133] or another qualified plan.[134] An "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

Distributions from tax-sheltered annuities

Eligible rollover distributions from a tax-sheltered annuity ("section 403(b) annuity") may be rolled over into an IRA or another section 403(b) annuity. Distributions from a section 403(b) annuity cannot be rolled over into a tax-qualified plan. Section 403(b) annuities are not required to accept rollovers.

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[133] A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refers only to traditional IRAs.

[134] An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

IRA distributions

Distributions from a traditional IRA, other than minimum required distributions, can be rolled over into another IRA. In general, distributions from an IRA cannot be rolled over into a qualified plan or section 403(b) annuity. An exception to this rule applies in the case of so-called "conduit IRAs." Under the conduit IRA rule, amounts can be rolled from a qualified plan into an IRA and then subsequently rolled back to another qualified plan if the amounts in the IRA are attributable solely to rollovers from a qualified plan. Similarly, an amount may be rolled over from a section 403(b) annuity to an IRA and subsequently rolled back into a section 403(b) annuity if the amounts in the IRA are attributable solely to rollovers from a section 403(b) annuity.

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section 457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

Section 457 benefits can be transferred to another section 457 plan. Distributions from a section 457 plan cannot be rolled over to another section 457 plan, a qualified plan, a section 403(b) annuity, or an IRA.

Rollovers by surviving spouses

A surviving spouse that receives an eligible rollover distribution may roll over the distribution into an IRA, but not a qualified plan or section 403(b) annuity.

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.

Notice of eligible rollover distribution

The plan administrator of a qualified plan or a section 403(b) annuity is required to provide a written explanation of rollover rules to individuals who receive a distribution eligible for rollover. In general, the notice is to be provided within a reasonable period of time before making the distribution and is to include an explanation of (1) the provisions under which the individual may have the distribution directly rolled over to another eligible retirement plan, (2) the provision that requires withholding if the distribution is not directly rolled over, (3) the provision under which the distribution may be rolled over within 60 days of receipt, and (4) if

applicable, certain other rules that may apply to the distribution. The Treasury Department has provided more specific guidance regarding timing and content of the notice.

Taxation of distributions

As is the case with the rollover rules, different rules regarding taxation of benefits apply to different types of tax-favored arrangements. In general, distributions from a qualified plan, section 403(b) annuity, or IRA are includible in income in the year received. In certain cases, distributions from qualified plans are eligible for capital gains treatment and averaging. These rules do not apply to distributions from another type of plan. Distributions from a qualified plan, IRA, and section 403(b) annuity generally are subject to an additional 10-percent early withdrawal tax if made before age 59½. There are a number of exceptions to the early withdrawal tax. Some of the exceptions apply to all three types of plans, and others apply only to certain types of plans. For example, the 10-percent early withdrawal tax does not apply to IRA distributions for educational expenses, but does apply to similar distributions from qualified plans and section 403(b) annuities. Benefits under a section 457 plan are generally includible in income when paid or made available. The 10-percent early withdrawal tax does not apply to section 457 plans.

House Bill

In general

The House bill provides that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, and governmental section 457 plans generally may be rolled over to any of such plans or arrangements.[135] Similarly, distributions from an IRA generally may be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules are extended to distributions from a governmental section 457 plan, and such plans are required to provide the written notification regarding eligible rollover distributions. The rollover notice (with respect to all plans) is required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan. Qualified plans, section 403(b) annuities, and section 457 plans are not required to accept rollovers.

Some special rules apply in certain cases. A distribution from a qualified plan is not eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under present law. Thus, in order to preserve capital gains and averaging treatment for a qualified plan distribution that is rolled over, the rollover has to be made to a "conduit IRA" as under present law, and then rolled back into a qualified plan. Amounts distributed from a section 457 plan are subject to the early withdrawal tax to the extent the distribution consists of

[135] Hardship distributions from governmental section 457 plans would be considered eligible rollover distributions.

amounts attributable to rollovers from another type of plan. Section 457 plans are required to separately account for such amounts.

The provision also provides that benefits in governmental section 457 plans are includible in income when paid.

Rollover of after-tax contributions

The provision provides that employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover may be accomplished only through a direct rollover. In addition, a qualified plan may not accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). After-tax contributions (including nondeductible contributions to an IRA) may not be rolled over from an IRA into a qualified plan, tax-sheltered annuity, or section 457 plan.

In the case of a distribution from a traditional IRA that is rolled over into an eligible rollover plan that is not an IRA, the distribution is attributed first to amounts other than after-tax contributions.

Expansion of spousal rollovers

The provision provides that surviving spouses may roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the spouse participates.

Treasury regulations

The Secretary is directed to prescribe rules necessary to carry out the provisions. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to rollovers. It is anticipated that the IRS will develop forms to assist individuals who roll over after-tax contributions to an IRA in keeping track of such contributions. Such forms could, for example, expand Form 8606—Nondeductible IRAs, to include information regarding after-tax contributions.

Effective date

The provision is effective for distributions made after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Waiver of 60-day rule (sec. 1234 of the House bill, sec. 334 of the Senate amendment, and secs. 402 and 408 of the Code)

Present Law

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement.

House Bill

The House bill provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.

Effective date.—The House bill provision applies to distributions made after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Treatment of forms of distribution (sec. 1235 of the House bill, sec. 335 of the Senate amendment, and sec. 411(d)(6) of the Code)

Present Law

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).[136]

The prohibition against the elimination of an optional form of benefit applies to plan mergers, spinoffs, transfers, and transactions amending or having the effect of amending a plan or plans to transfer plan benefits. For example, if Plan A, a profit-sharing plan that provides for distribution of benefits in annual installments over ten or twenty years, is merged with Plan B, a profit-sharing plan that provides for distribution of benefits in annual installments over life expectancy at the time of retirement, the merged plan must preserve the ten- or twenty-year installment option with respect to benefits accrued under Plan A as of the date of the merger and the installments over life expectancy with respect to benefits accrued under Plan B as of the date of the merger.

[136] A similar provision is contained in Title I of ERISA.

Similarly, for example, if a participant's benefit under a defined contribution plan is transferred to another defined contribution plan maintained by the same or a different employer, the optional forms of benefit available with respect to the participant's accrued benefit under the transferor plan must be preserved.[137]

House Bill

A defined contribution plan to which benefits are transferred is not treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, (4) if the transferor plan provides for an annuity as the normal form of distribution in accordance with the joint and survivor annuity rules (sec. 417), the participant's spouse (if any) consents to the transfer in a manner similar to the consent required by section 417, and (5) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution.

In addition, except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan is not treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution previously available under the plan, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the form of distribution eliminated by the amendment.

The Secretary is directed to issue, not later than December 31, 2001, final regulations under section 411(d)(6) implementing the provision.

Furthermore, the provision authorizes the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit not apply to plan amendments that do not adversely affect the rights of participants in a material manner but that do eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants.

Effective date.—The provision is effective for years beginning after December 31, 2000, except that the direction to the Secretary regarding regulations is effective on the date of enactment.

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[137] Treas. Reg. sec. 1.411(d)–4, Q&A–2(a)(3)(i).

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment, with the modification that the Secretary is required to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit not apply to plan amendments that do not adversely affect the rights of participants in a material manner but that do eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants. As under the House bill and the Senate amendment, the conferees intend that the factors to be considered in determining whether an amendment has a materially adverse effect on a participant would include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

The conference agreement clarifies that the Secretary is to issue final regulations under section 411(d)(6), including regulations required under the provision, no later than December 31, 2001.

Effective date.—The provision is generally effective for years beginning after December 31, 2001. The direction to the Secretary regarding regulations is effective on the date of enactment.

4. Rationalization of restrictions on distributions (sec. 1236 of the House bill, sec. 336 of the Senate amendment, and secs. 401(k), 403(b), and 457 of the Code)

Present Law

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), tax-sheltered annuity ("section 403(b) annuity"), or an eligible deferred compensation plan of a tax-exempt organization or State or local government ("section 457 plan"), may not be distributable prior to the occurrence of one or more specified events. These permissible distributable events include "separation from service."

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar cor-

porate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.[138]

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but does not experience a separation from service because the employee continues on the same job for a different employer as a result of a corporate transaction. If the corporation disposes of substantially all of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary.

House Bill

The House bill modifies the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. In addition, the provisions for distribution from a section 401(k) plan based upon a corporation's disposition of its assets or a subsidiary are repealed; this special rule is no longer necessary under the provision.

Effective date.—The provision is effective for distributions after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Purchase of service credit under governmental pension plans (sec. 1237 of the House bill, sec. 337 of the Senate amendment, and secs. 403(b) and 457 of the Code)

Present Law

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make after-tax employee contributions in order to purchase permissive service credit, subject to certain limits (sec. 415). Permissive service credit means credit for a period of service recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of

[138] Rev. Rul. 79–336, 1979–2 C.B. 187.

service and that is in addition to the regular employee contributions, if any, under the plan.

In the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State), any such repayment is not taken into account for purposes of the section 415 limits on contributions and benefits. Also, service credit obtained as a result of such a repayment is not considered permissive service credit for purposes of the section 415 limits.

A participant may not use a rollover or direct transfer of benefits from a tax-sheltered annuity ("section 403(b) annuity") or an eligible deferred compensation plan of a tax-exempt organization of a State or local government ("section 457 plan") to purchase permissive service credits or repay contributions and earnings with respect to a forfeiture of service credit.

House Bill

A participant in a State or local governmental plan is not required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).

Effective date.—The provision is effective for transfers after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

6. Employers may disregard rollovers for purposes of cash-out rules (sec. 1238 of the House bill, sec. 338 of the Senate amendment, and sec. 411(a)(11) of the Code)

Present Law

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the re-

turn need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.[139]

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.[140]

House Bill

Under the House bill, a plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto).

Effective date.—The provision is effective for distributions after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.[141]

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

D. Strengthening Pension Security And Enforcement

1. Phase in repeal of 150 percent of current liability funding limit; deduction for contributions to fund termination liability (secs. 1241–1242 of the House bill, secs. 341 and 347 of the Senate amendment, and secs. 404(a)(1), 412(c)(7), and 4972(c) of the Code)

Present Law

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)).[142] In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004,

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[139] A similar provision is cntained in Title I of ERISA.

[140] Other provisions of the House bill expand the kinds of plans to which benefits may be rolled over.

[141] The Senate amendment also makes changes to the corresponding provisions of ERISA.

[142] The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

and 170 percent for plan years beginning in 2005 and thereafter.[143] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

House Bill

Current liability full funding limit

The House bill gradually increases and then repeals the current liability full funding limit. The current liability full funding limit is 160 percent of current liability for plan years beginning in 2001, 165 percent for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the provision applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.[144]

The House bill also modifies the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for the plan year, termination liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

Effective date

The House bill is effective for plan years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.[145]

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[143] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text.

[144] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

[145] The Senate amendment also amends the corresponding provisions of ERISA.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

2. Excise tax relief for sound pension funding (sec. 1243 of the House bill, sec. 343 of the Senate amendment, and sec. 4972 of the Code)

Present Law

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 155 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 160 percent for plan years beginning in 2001 or 2002, 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[146] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Present law also provides that contributions to defined contribution plans are deductible, subject to certain limitations.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. The 10-percent excise tax does not apply to contributions to certain terminating defined benefit plans. The 10-percent excise tax also does not apply to contributions of up to 6 percent of compensation to a defined contribution plan for employer matching and employee elective deferrals.

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[146] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, and adopted the scheduled increases described in the text. Another provision in the bill gradually increases and then repeals the current liability full funding limit.

House Bill

In determining the amount of nondeductible contributions, the employer may elect not to take into account contributions to a defined benefit pension plan except to the extent they exceed the accrued liability full funding limit. Thus, if an employer elects, contributions in excess of the current liability full funding limit are not subject to the excise tax on nondeductible contributions. An employer making such an election for a year may not take advantage of the present-law exceptions for certain terminating plans and certain contributions to defined contribution plans.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Notice of significant reduction in plan benefit accruals (sec. 1244 of the House bill, sec. 344 of the Senate amendment, new sec. 4980F of the Code, and sec. 204(h) of ERISA)

Present Law

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be understood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations[147] provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of fu-

[147] Treas. Reg. sec. 1.411(d)–6.

ture benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

The Internal Revenue Code does not require any notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

House Bill

The House bill adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan or a money purchase pension plan with more than 100 participants furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual. The plan administrator is required to provide in this notice, in a manner calculated to be understood by the average plan participant, sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment.

The plan administrator is required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. For purposes of the House bill, an affected participant or alternate payee is a participant or alternate payee to whom the significant reduction in the rate of future benefit accrual is reasonably expected to apply.

Except to the extent provided by Treasury regulations, the plan administrator is required to provide the notice within a reasonable time before the effective date of the plan amendment.

The provision imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. For failures due to reasonable cause and not to willful neglect, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

The legislative history indicates that it is anticipated that the Secretary will issue the necessary regulations within 90 days of enactment and that such guidance may be relatively detailed because of the need to provide for alternative disclosures rather than a single disclosure methodology that may not fit all situations, and the need to consider the complex actuarial calculations and assumptions involved in providing necessary disclosures.

Effective date.—The House bill is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the House bill will not end before the last day of the 3-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan will be treated as meeting the requirements of the provision if the plan makes a good faith effort to comply with such requirements.

Senate Amendment

The Senate amendment adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy.[148] The notice must set forth the plan amendment and its effective date and provide sufficient information (as defined in Treasury regulations) to allow participants to understand how the amendment generally will affect different classes of employees. The plan administrator is required to provide the notice not less than 30 days before the effective date of the plan amendment.

The plan administrator must provide this generalized notice to each participant and alternate payee to whom the amendment applies, and to each employee organization representing such individuals. The plan administrator is not required to provide this notice to any participant who has less than 1 year of participation in the plan or who is entitled to receive the greater of the participant's accrued benefit under the amended plan formula or under the formula as in effect immediately prior to the amendment effective date.

If the amendment provides for a significant change in the manner in which accrued benefits are determined under the plan, or requires an affected participant or affected alternate payee to choose between 2 or more benefit formulas, the plan administrator is required to provide an additional notice to each affected participant and affected alternate payee within 6 months after the effective date of the amendment. For purposes of the Senate amendment, an affected participant or alternate payee generally is a participant or alternate payee to whom the significant reduction in the rate of future benefit accrual is reasonably expected to apply. A participant who has less than 1 year of participation in the plan, or who is entitled to receive the greater of the participant's accrued benefit under the amended plan formula or under the formula as in effect immediately prior to the amendment effective date, is not an affected participant.

The legislative history provides that an example of an amendment that provides for a significant change in the manner in which accrued benefits are determined is an amendment that replaces a benefit formula that defines a participant's normal retirement ben-

[148] The provision also modifies the present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual unles the plan administrator complies with a notice requirement similar to the notice requirement that the provision adds to the Internal Revenue Code.

efit as a percentage of the participant's final average compensation with a benefit formula that defines a participant's normal retirement benefit in terms of a hypothetical account credited with annual allocations of contributions and interest. The legislative history also provides that examples of amendments that do not provide for a significant change in the manner in which accrued benefits are determined are (1) an amendment that reduces the percentage of average compensation that the plan provides as an annual benefit commencing at normal retirement age from 60 percent to 50 percent, and (2) an amendment that modifies the definition of compensation used to determine average compensation by providing for the exclusion of bonuses and overtime.

The plan administrator is required to provide in this additional notice (1) the individual's accrued benefit (and, if the amendment adds the option of an immediate lump sum distribution, the present value of the accrued benefit) as of the amendment effective date, determined under the terms of the plan in effect immediately before the effective date, (2) the individual's accrued benefit as of the amendment effective date, determined under the terms of the plan in effect on the amendment effective date and without regard to any minimum accrued benefit that may not be decreased by the amendment (sec. 411(d)(6)), and (3) either (a) sufficient information (as defined in Treasury regulations) for the individual to compute his or her projected accrued benefit or to acquire information necessary to compute such projected accrued benefit, or (b) a determination of the individual's projected accrued benefit with a disclosure of the assumptions (which must be reasonable in the aggregate) used by the plan in determining the projected accrued benefit. For purposes of this additional notice, an individual's accrued benefit and projected accrued benefit are computed as if the accrued benefit were in the form of a single life annuity at normal retirement age, taking into account any early retirement subsidy.

The legislative history provides that, with respect to the description of the individual's accrued benefit as of the amendment effective date, an example of determining such benefit under the terms of the plan in effect on the amendment effective date and without regard to the sec. 411(d)(6) protected benefit is a situation in which (1) an amendment replaces a benefit formula that defines a participant's normal retirement benefit as a percentage of the participant's final average compensation with a benefit formula that defines a participant's normal retirement benefit in terms of a hypothetical account credited with annual allocations of contributions and interest, (2) the amendment adds the option of an immediate lump sum distribution, (3) the present value of a participant's sec. 411(d)(6) protected benefit is $50,000, and (4) the beginning balance of the participant's hypothetical account balance under the terms of the plan in effect on the amendment effective date is $25,000. In this example, the required notice would inform the participant that, as of the amendment effective date, the individual's accrued benefit determined under the terms of the plan in effect immediately before the effective date is $50,000, and the individual's accrued benefit determined under the terms of the plan in effect on the amendment effective date is $25,000.

With respect to a plan amendment that requires an affected participant or affected alternate payee to choose between 2 or more benefit formulas, the Secretary of the Treasury, after consultation with the Secretary of Labor, is authorized to require additional information to be provided in the notices and to require either of the notices to be provided at a different time. The legislative history states that this authorization is not intended to result in a modification of the present-law fiduciary requirements under Title I of ERISA.

Under the Senate amendment, the notice requirement does not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)).

The Senate amendment generally imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. For failures due to reasonable cause and not to willful neglect, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved. The legislative history provides that an example of facts and circumstances under which reasonable cause may exist for a failure to comply with the notice requirement is a plan administrator's inability to provide the required generalized notice concerning a plan amendment if the amendment results from a business merger or acquisition transaction and the timing of the transaction prevents the plan administrator from providing the notice at least 30 days prior to the effective date of the amendment.

Effective date.—The Senate amendment is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the provision will not end before the last day of the 3-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan will be treated as meeting the requirements of the provision if the plan makes a good faith effort to comply with such requirements. Pending the issuance of regulations, the legislative history provides that examples of good faith compliance in which the Senate amendment would not require additional employee communications include: (1) A plan amendment provides that participants may choose to have their accrued benefits determined under the amended plan formula or under the formula as in effect immediately prior to the amendment effective date, and the plan administrator provides participants with comparison information, including clearly stated assumptions, relative to the amended and prior formulas so that participants are able to make an informed decision; (2) A plan administrator provides to participants estimates of accrued benefits at various career stages, determined under the amended plan formula and under the formula as in effect immediately prior to the amendment effective date, including clearly stated assumptions, and stated as annuities and/or lump sums (without regard to section 417) as appropriate under the plan provisions; (3) An employer informs certain employees before they are hired that the employer's

current plan benefit formula will be amended at a specified future date, and these employees participate in the plan under the formula as in effect immediately prior to the amendment until such specified future date (good faith compliance would be relevant for these employees only).

Conference Agreement

The conference agreement follows the House bill, with modifications. Under the conference agreement, the notice requirement does not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)). The provision also modifies the present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual unless the plan administrator complies with a notice requirement similar to the notice requirement that the provision adds to the Internal Revenue Code.

The conferees intend that in issuing regulations under the provision, the Treasury Department generally will follow the approach under the Senate amendment. Thus, the conferees intend that Treasury regulations will provide for a notice that describes how the amendment generally will affect different classes of employees and that the regulations will require the plan administrator to furnish this notice not less than 30 days before the effective date of the amendment. With respect to an amendment that provides for a significant change in the manner in which accrued benefits are determined under the plan, or requires an affected participant or affected alternate payee to choose between 2 or more benefit formulas, the conferees intend that the regulations will require the plan administrator to provide an additional notice to each affected participant and affected alternate payee within 6 months after the effective date of the amendment.

An example of an amendment that provides for a significant change in the manner in which accrued benefits are determined is an amendment that replaces a benefit formula that defines a participant's normal retirement benefit as a percentage of the participant's final average compensation with a benefit formula that defines a participant's normal retirement benefit in terms of a hypothetical account credited with annual allocations of contributions and interest. Examples of amendments that do not provide for a significant change in the manner in which accrued benefits are determined are (1) an amendment that reduces the percentage of average compensation that the plan provides as an annual benefit commencing at normal retirement age from 60 percent to 50 percent, and (2) an amendment that modifies the definition of compensation used to determine average compensation by providing for the exclusion of bonuses and overtime.

The conferees intend that the regulations will require the plan administrator to provide in this additional notice (1) the individual's accrued benefit (and, if the amendment adds the option of an immediate lump sum distribution, the present value of the accrued benefit) as of the amendment effective date, determined under the

terms of the plan in effect immediately before the effective date, (2) the individual's accrued benefit as of the amendment effective date, determined under the terms of the plan in effect on the amendment effective date and without regard to any minimum accrued benefit that may not be decreased by the amendment (sec. 411(d)(6)), and (3) either (a) sufficient information for the individual to compute his or her projected accrued benefit or to acquire information necessary to compute such projected accrued benefit, or (b) a determination of the individual's projected accrued benefit with a disclosure of the assumptions (which must be reasonable in the aggregate) used by the plan in determining the projected accrued benefit. The conferees intend that the regulations will provide that, for purposes of this additional notice, an individual's accrued benefit and projected accrued benefit are computed as if the accrued benefit were in the form of a single life annuity at normal retirement age, taking into account any early retirement subsidy.

With respect to the description of the individual's accrued benefit as of the amendment effective date, an example of determining such benefit under the terms of the plan in effect on the amendment effective date and without regard to the sec. 411(d)(6) protected benefit is a situation in which (1) an amendment replaces a benefit formula that defines a participant's normal retirement benefit as a percentage of the participant's final average compensation with a benefit formula that defines a participant's normal retirement benefit in terms of a hypothetical account credited with annual allocations of contributions and interest, (2) the amendment adds the option of an immediate lump sum distribution, (3) the present value of a participant's sec. 411(d)(6) protected benefit is $50,000, and (4) the beginning balance of the participant's hypothetical account balance under the terms of the plan in effect on the amendment effective date is $25,000. In this example, the conferees intend that the regulations would provide that the required notice would inform the participant that, as of the amendment effective date, the individual's accrued benefit determined under the terms of the plan in effect immediately before the effective date is $50,000, and the individual's accrued benefit determined under the terms of the plan in effect on the amendment effective date is $25,000.

With respect to a plan amendment that requires an affected participant or affected alternate payee to choose between 2 or more benefit formulas, the conferees intend that the Secretary of the Treasury, after consultation with the Secretary of Labor, may require additional information to be provided in the notices and to require either of the notices to be provided at a different time. The conferees do not intend this authorization to result in a modification of the present-law fiduciary requirements under Title I of ERISA.

An example of facts and circumstances under which reasonable cause may exist for a failure to comply with the notice requirement is a plan administrator's inability to provide the required generalized notice concerning a plan amendment if the amendment results from a business merger or acquisition transaction and the timing of the transaction prevents the plan administrator from providing

the notice at least 30 days prior to the effective date of the amendment.

Effective date.—The conference agreement follows the House bill and the Senate amendment. As under the Senate amendment, pending the issuance of regulations, examples of good faith compliance in which the provision would not require additional employee communications include: (1) A plan amendment provides that participants may choose to have their accrued benefits determined under the amended plan formula or under the formula as in effect immediately prior to the amendment effective date, and the plan administrator provides participants with comparison information, including clearly stated assumptions, relative to the amended and prior formulas so that participants are able to make an informed decision; (2) A plan administrator provides to participants estimates of accrued benefits at various career stages, determined under the amended plan formula and under the formula as in effect immediately prior to the amendment effective date, including clearly stated assumptions, and stated as annuities and/or lump sums (without regard to section 417) as appropriate under the plan provisions; (3) An employer informs certain employees before they are hired that the employer's current plan benefit formula will be amended at a specified future date, and these employees participate in the plan under the formula as in effect immediately prior to the amendment until such specified future date (good faith compliance would be relevant for these employees only).

4. Extension of PBGC missing participants program (sec. 342 of the Senate amendment, and secs. 206(f) and 4050 of ERISA)

Present Law

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

House Bill

No provision.

Senate Amendment

The PBGC is directed to prescribe for terminating multiemployer plans rules similar to the present-law missing participant

rules applicable to terminating single employer plans that are subject to Title IV of ERISA.

Effective date.—The Senate amendment is effective for distributions from terminating plans that occur after the PBGC adopts final regulations implementing the Senate amendment.

Conference Agreement

The conference agreement follows the Senate amendment, with modifications. In addition to the extension of the missing participant program to multiemployer plans, to the extent provided in PBGC regulations, plan administrators of certain types of plans that are not covered by the PBGC missing participant program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the provision extends the missing participants program to defined contribution plans, defined benefit plans that do not have more than 25 active participants and are maintained by professional service employers, and the portions of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective date.—The conference agreement is effective with respect to distributions made after the PBGC adopts final regulations implementing the provision.

5. Investment of employee contributions in 401(k) plans (sec. 345 of the Senate amendment)

Present Law

The Employee Retirement Income Security Act of 1974, as amended ("ERISA") prohibits certain employee benefit plans from acquiring securities or real property of the employer who sponsors the plan if, after the acquisition, the fair market value of such securities and property exceeds 10 percent of the fair market value of plan assets. The 10-percent limitation does not apply to any "eligible individual account plans" that specifically authorize such investments. Generally, eligible individual account plans are defined contribution plans, including plans containing a cash or deferred arrangement ("401(k) plans").

The term "eligible individual account plan" does not include the portion of a plan that consists of elective deferrals (and earnings on the elective deferrals) made under section 401(k) if elective deferrals equal to more than 1 percent of any employee's eligible compensation are required to be invested in employer securities and employer real property. Eligible compensation is compensation that is eligible to be deferred under the plan. The portion of the plan that consists of elective deferrals (and earnings thereon) is still treated as an individual account plan, and the 10-percent limitation does not apply, as long as elective deferrals (and earnings thereon) are not required to be invested in employer securities or employer real property.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply if individual account plans are a small part of the employer's retire-

ment plans. In particular, that rule does not apply to an individual account plan for a plan year if the value of the assets of all individual account plans maintained by the employer do not exceed 10 percent of the value of the assets of all pension plans maintained by the employer (determined as of the last day of the preceding plan year). Multiemployer plans are not taken into account in determining whether the value of the assets of all individual account plans maintained by the employer exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply to an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan applies to elective deferrals for plan years beginning after December 31, 1998 (and earnings thereon). It does not apply with respect to earnings on elective deferrals for plan years beginning before January 1, 1999.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the effective date of the rule excluding certain elective deferrals (and earnings thereon) from the definition of individual account plan by providing that the rule does not apply to any elective deferral used to acquire an interest in the income or gain from employer securities or employer real property acquired (1) before January 1, 1999, or (2) after such date pursuant to a written contract which was binding on such date and at all times thereafter.

Effective date.—The Senate amendment is effective as if included in the section of the Taxpayer Relief Act of 1997 that contained the rule excluding certain elective deferrals (and earnings thereon).

Conference Agreement

The conference agreement follows the Senate amendment, with a modification to eliminate the exception for employer securities or real property acquired pursuant to certain binding contracts. Thus, under the conference agreement, the rule excluding certain elective deferrals (and earnings thereon) from the definition of individual account plan does not apply to any elective deferral used to acquire an interest in the income or gain from employer securities or employer real property acquired before January 1, 1999.

Effective date.—The conference agreement follows the Senate amendment.

6. Periodic pension benefit statements (sec. 351 of the Senate amendment and sec. 105 of ERISA)

Present Law

Title I of ERISA provides that a pension plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. This statement must indicate, on the basis of the latest available information, (1) the participant's or beneficiary's total accrued benefit, and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than 1 benefit statement during any 12-month period. The plan administrator must furnish the benefit statement no later than 60 days after receipt of the request or, if later, 120 days after the close of the immediately preceding plan year.

In addition, the plan administrator must furnish a benefit statement to each participant whose employment terminates or who has a 1-year break in service. For purposes of this benefit statement requirement, a "1-year break in service" is a calendar year, plan year, or other 12-month period designated by the plan during which the participant does not complete more than 500 hours of service for the employer. A participant is not entitled to receive more than 1 benefit statement with respect to consecutive breaks in service. The plan administrator must provide a benefit statement required upon termination of employment or a break in service no later than 180 days after the end of the plan year in which the termination of employment or break in service occurs.

House Bill

No provision.

Senate Amendment

A plan administrator of a defined contribution plan generally must furnish a benefit statement to each participant at least once annually and to a beneficiary upon written request.

In addition to providing a benefit statement to a beneficiary upon written request, the plan administrator of a defined benefit plan generally must either (1) furnish a benefit statement at least once every 3 years to each participant who has a vested accrued benefit and who is employed by the employer at the time the plan administrator furnishes the benefit statements to participants, or (2) annually furnish written, electronic, telephonic, or other appropriate notice to each participant of the availability of and the manner in which the participant may obtain the benefit statement.

The plan administrator of a multiemployer plan or a multiple employer plan is required to furnish a benefit statement only upon written request of a participant or beneficiary.[149]

The plan administrator is required to write the benefit statement in a manner calculated to be understood by the average plan

[149] A multiple employer plan is a plan that is maintained by 2 or more unrelated employers but that is not maintained pursuant to a collective bargaining (sec. 413(c)).

participant and is permitted to furnish the statement in written, electronic, telephonic, or other appropriate form.

Effective date.—The Senate amendment is effective for plan years beginning after December 31, 2000.

Conference Agreement

The conference agreement does not include the Senate amendment.

E. Reducing Regulatory Burdens

1. Repeal of the multiple use test (sec. 1251 of the House bill and sec. 401(m) of the Code)

Present Law

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan") are subject to a special annual nondiscrimination test ("ADP test"). The ADP test compares the actual deferral percentages ("ADPs") of the highly compensated employee group and the nonhighly compensated employee group. The ADP for each group generally is the average of the deferral percentages separately calculated for the employees in the group who are eligible to make elective deferrals for all or a portion of the relevant plan year. Each eligible employee's deferral percentage generally is the employee's elective deferrals for the year divided by the employee's compensation for the year.

The plan generally satisfies the ADP test if the ADP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ADP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ADP of the nonhighly compensated employee group for the prior plan year and not more than 2 percentage points greater than the ADP of the nonhighly compensated employee group for the prior plan year.

Employer matching contributions and after-tax employee contributions under a defined contribution plan also are subject to a special annual nondiscrimination test ("ACP test"). The ACP test compares the actual deferral percentages ("ACPs") of the highly compensated employee group and the nonhighly compensated employee group. The ACP for each group generally is the average of the contribution percentages separately calculated for the employees in the group who are eligible to make after-tax employee contributions or who are eligible for an allocation of matching contributions for all or a portion of the relevant plan year. Each eligible employee's contribution percentage generally is the employee's aggregate after-tax employee contributions and matching contributions for the year divided by the employee's compensation for the year.

The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than 2 per-

centage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

For any year in which (1) at least one highly compensated employee is eligible to participate in an employer's plan or plans that are subject to both the ADP test and the ACP test, (2) the plan subject to the ADP test satisfies the ADP test but the ADP of the highly compensated employee group exceeds 125 percent of the ADP of the nonhighly compensated employee group, and (3) the plan subject to the ACP test satisfies the ACP test but the ACP of the highly compensated employee group exceeds 125 percent of the ACP of the nonhighly compensated employee group, an additional special nondiscrimination test ("Multiple Use test") applies to the elective deferrals, employer matching contributions, and after-tax employee contributions. The plan or plans generally satisfy the Multiple Use test if the sum of the ADP and the ACP of the highly compensated employee group does not exceed the greater of (1) the sum of (A) 1.25 times the greater of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the lesser of the ADP or the ACP of the nonhighly compensated employee group, or (2) the sum of (A) 1.25 times the lesser of the ADP or the ACP of the nonhighly compensated employee group, and (B) 2 percentage points plus (but not more than 2 times) the greater of the ADP or the ACP of the nonhighly compensated employee group.

House Bill

The House bill repeals the Multiple Use test.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Modification of timing of plan valuations (sec. 1252 of the House bill, sec. 362 of the Senate amendment, and sec. 412 of the Code)

Present Law

Under present law, in the case of plans subject to the minimum funding rules, a plan valuation is generally required annually. The Secretary may require that a valuation be made more frequently in particular cases.

Prior to the Retirement Protection Act of 1994, plan valuations generally were required at least once every three years.

House Bill

The House bill allows an employer to elect to use the prior year's plan valuation in certain cases. The election may be made only with respect to a defined benefit plan with assets of at least

125 percent of current liability (determined as of the valuation date for the preceding year). If the prior year's valuation is used, it must be adjusted, as provided in regulations, to reflect significant differences in participants. An election made under the House bill may be revoked only with the consent of the Secretary. In any event, a plan valuation is required once every three years.[150]

Effective date.—The House bill is effective for plan years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

3. Flexibility in nondiscrimination and line of business rules (sec. 1253 of the House bill, sec. 361 of the Senate amendment, and secs. 401(a)(4), 410(b), and 414(r) of the Code)

Present Law

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

House Bill

The Secretary of the Treasury is directed to modify, on or before December 31, 2000, the existing regulations issued under section 401(a)(4) and section 414(r) in order to expand (to the extent

[150] As under present law, the Secretary could require that a valuation be made more frequently in particular cases.

that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the nondiscrimination and line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

The Secretary of the Treasury is directed to provide by regulation applicable to years beginning after December 31, 2000, that a plan is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfies the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

Similarly, a plan complies with the minimum coverage requirement of section 410(b) if the plan satisfies the pre-1989 coverage rules, is submitted to the Secretary for a determination of whether it satisfies the pre-1989 coverage rules (to the extent provided by the Secretary), and satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of the pre-1989 coverage rules.

Effective date.—The Senate amendment is effective on the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment with respect to coverage and nondiscrimination rules and the House bill with respect to line of business rules.

4. ESOP dividends may be reinvested without loss of dividend deduction (sec. 1254 of the House bill, sec. 364 of the Senate amendment, and sec. 404(k) of the Code)

Present Law

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

House Bill

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

5. Notice and consent period regarding distributions (sec. 1255 of the House bill, sec. 365 of the Senate amendment, and sec. 417 of the Code)

Present Law

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent and the consent of the participant's spouse to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.[151]

If the present value of the participant's vested accrued benefit exceeds $5,000, the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, and (2) in certain cases, the right, if any, to defer receipt of the distribution. In addition, the plan must provide to the participant notice of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, the plan must provide to the participant a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive

[151] Similar provisions are contained in Title I of ERISA.

the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide these 3 notices to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. The plan generally is required, however, to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

House Bill

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 6 months before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 6 months and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

Senate Amendment

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 12 months before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 12 months and to provide that the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective date.—The Senate amendment is effective for years beginning after December 31, 2000.

Conference Agreement

No provision.

6. Repeal transition rule relating to certain highly compensated employees (sec. 1256 of the House bill, sec. 366 of the Senate amendment, and sec. 414(q) of the Code)

Present Law

Under present law, for purposes of the rules relating to qualified plans, a highly compensated employee is generally defined as an employee[152] who (1) was a 5-percent owner of the employer at

[152] An employee includes a self-employed individual.

any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $80,000 (for 1999) or (b) at the election of the employer, had compensation in excess of $80,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

Under a rule enacted in the Tax Reform Act of 1986, a special definition of highly compensated employee applies for purposes of the nondiscrimination rules relating to qualified cash or deferred arrangements ("section 401(k) plans") and matching contributions. This special definition applies to an employer incorporated on December 15, 1924, that meets certain specific requirements.

House Bill

The House bill repeals the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition applies.

Effective date.—The House bill is effective for plan years beginning after December 31, 2000.

Senate Amendment

The Senate amendment is the same as the House bill.

Effective date.—The Senate amendment is effective for plan years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

7. Employees of tax-exempt entities (sec. 1257 of the House bill, sec. 367 of the Senate amendment, and sec. 410 of the Code)

Present Law

The Tax Reform Act of 1986 provided that nongovernmental tax-exempt employers were not permitted to maintain a qualified cash or deferred arrangement ("section 401(k) plan"). This prohibition was repealed, effective for years beginning after December 31, 1996, by the Small Business Job Protection Act of 1996.

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could participate in the section 401(k) plan benefit under the plan for the plan year.[153]

Tax-exempt charitable organizations may maintain a tax-sheltered annuity (a "section 403(b) annuity") that allows employees to make salary reduction contributions.

[153] Treas. Reg. sec. 1.410(b)–6(g).

House Bill

The Treasury Department is directed to revise its regulations under section 410(b) to provide that employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer if (1) no employee of such tax-exempt entity is eligible to participate in the section 401(k) or 401(m) plan and (2) at least 95 percent of the employees who are not employees of the charitable employer are eligible to participate in such section 401(k) plan or section 401(m) plan.

The revised regulations will be effective for years beginning after December 31, 1996.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

8. Treatment of employer-provided retirement advice (sec. 1258 of the House bill, sec. 352 of the Senate amendment, and sec. 132 of the Code)

Present Law

Under present law, certain employer-provided fringe benefits are excludable from gross income (sec. 132) and wages for employment tax purposes. These excludable fringe benefits include working condition fringe benefits and de minimis fringes. In general, a working condition fringe benefit is any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction as a business expense. A de minimis fringe benefit is any property or services provided by the employer the value of which, after taking into account the frequency with which similar fringes are provided, is so small as to make accounting for it unreasonable or administratively impracticable.

In addition, if certain requirements are satisfied, up to $5,250 annually of employer-provided educational assistance is excludable from gross income (sec. 127) and wages. This exclusion expires with respect to courses beginning after May 31, 2000.[154] Education not excludable under section 127 may be excludable as a working condition fringe.

There is no specific exclusion under present law for employer-provided retirement planning services. However, such services may

[154] The exclusion does not apply with respect to graduate-level courses.

be excludable as employer-provided educational assistance or a fringe benefit.

House Bill

Qualified retirement planning services provided to an employee and his or her spouse are excludable from income and wages. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's pension plan. The exclusion is not limited to information regarding the plan but includes, for example, information regarding how the plan relates to retirement income planning as a whole.

Effective date.—The House bill is effective with respect to taxable years beginning after December 31, 2000.

Senate Amendment

Under the Senate amendment, qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan are excludable from income and wages. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan. The exclusion is intended to allow employers to provide advice and information regarding retirement planning. The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion is not intended to apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

Effective date.—The Senate amendment is effective with respect to taxable years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment. As under the Senate amendment, the exclusion is intended to allow employers to provide advice and information regarding retirement planning. The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion is not intended to apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services. The conferees also intend that the provision is not to be interpreted as narrowing present law.

9. Provisions relating to plan amendments (sec. 1259 of the House bill and sec. 371 of the Senate amendment)

Present Law

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

House Bill

Any amendments to a plan or annuity contract required to be made by the House bill are not required to be made before the last day of the first plan year beginning on or after January 1, 2003. In the case of a governmental plan, the date for amendments is extended to the last day of the first plan year beginning on or after January 1, 2005.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

10. Model plans for small businesses (sec. 1260 of the House bill)

Present Law

The Internal Revenue Service ("IRS") previously has established uniform plan[155] and prototype plan[156] programs that were designed, in part, to simplify the preparation of qualified retirement plan documents and the determination letter application process. Neither the IRS nor the Secretary of the Treasury previously have issued model plan documents.

House Bill

The Secretary of the Treasury is directed to issue, not later than December 31, 2000, at least one model defined contribution plan document and at least one model defined benefit plan document that fit the needs of small businesses and that is treated as meeting the requirements of section 401(a) with respect to the form of the plan. To the extent that the requirements of section 401(a) are modified after the issuance of the model plans, the Secretary is directed to issue, in a timely manner, model amendments that, if adopted in a timely manner by an employer that adopts a model plan, will cause the model plan to be treated as meeting the re-

[155] Rev. Proc. 84–46, 1984–2 C.B. 787.

[156] Rev. Proc. 84–23, 1984–1 C.B. 457; Rev. Proc. 89–9, 1989–1 C.B. 780; Rev. Proc. 89–13, 1989–1 C.B. 801.

quirements of section 401(a), as modified, with respect to the form of the plan.

Alternatively, the Secretary is permitted, in its discretion, to enhance and simplify the existing prototype plan programs in a manner that achieves the purposes of the model plans.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

11. Reporting simplification (sec. 1261 of the House bill and sec. 371 of the Senate amendment)

Present Law

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[157] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Internal Revenue Service ("IRS"), which forwards the form to the Department of Labor and the PBGC.

The Form 5500 series consists of 3 different forms: Form 5500, Form 5500–C/R, and Form 5500–EZ. Form 5500 is the most comprehensive of the forms and requires the most detailed financial information. Form 5500–C/R requires less information than Form 5500, and Form 5500–EZ, which consists of only 1 page, is the simplest of the forms.

The size of the plan determines which form a plan administrator must file. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must file Form 5500. If the plan has fewer than 100 participants at the beginning of the plan year, the plan administrator generally may file Form 5500–C/R. A plan administrator generally may file Form 5500–EZ if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan

[157] Treas. Reg. sec. 301.6058–1(a).

in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500–EZ and the total value of the plan year and all prior plan years does not exceed $100,000, the plan administrator is not required to file a return.

House Bill

The Secretary of the Treasury is directed to provide for the filing of a simplified annual return substantially similar to the Form 5500–EZ by a plan that (1) covers less than 25 employees on the first day of the plan year, (2) is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) is maintained by an employer that is not a member of a related group of employers, and (4) is maintained by an employer that does not receive the services of leased employees.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

The Secretary of the Treasury is directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500–EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years does not exceed $500,000, the plan administrator is not required to file a return.

In addition, the Secretary of the Treasury is directed to provide for the filing of a simplified annual return substantially similar to the Form 5500–EZ by a plan that (1) covers less than 25 employees on the first day of the plan year, (2) is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) is maintained by an employer that is not a member of a related group of employers, and (4) is maintained by an employer that does not receive the services of leased employees.

Effective date.—The provision is effective on January 1, 2001.

Conference Agreement

The conference agreement follows the Senate amendment, with a modification. The Secretary of the Treasury is directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500–EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years does not exceed $250,000, the plan administrator is not required to file a return.

Effective date.—The provision is effective on January 1, 2001.

12. Improvement to Employee Plans Compliance Resolution System (sec. 1262 of the House bill)

Present Law

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan sat-

isfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a) and section 403(b), as applicable.[158] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Administrative Policy Regarding Self-Correction ("APRSC") permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a 2–year period, without payment of any fee or sanction. The Voluntary Compliance Resolution ("VCR") program, the Walk-In Closing Agreement Program ("Walk-In CAP"), and the Tax-Sheltered Annuity Voluntary Correction ("TVC") program permit an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

House Bill

The Secretary of the Treasury is directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under APRSC for significant

[158] Rev. Proc. 98–22, 1998–12 I.R.B. 11, as modified by Rev. Proc. 99–13, 1999–5, I.R.B. 52.

compliance failures, (4) expanding the availability to correct insignificant compliance failures under APRSC during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

Effective date.—The House bill is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

13. Modifications to section 415 limits for multiemployer and governmental plans (sec. 1263 of the House bill, secs. 346 and 348 of the Senate amendment, and sec. 415 of the Code)

Present Law

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415). The limits on contributions and benefits under qualified plans are based on the type of plan.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation for the highest three years, or (2) $130,000 (for 1999). The dollar limit is adjusted for cost-of-living increases in $5,000 increments. The dollar limit is reduced in the case of retirement before the social security retirement age and increases in the case of retirement after the social security retirement age.

A special rule applies to governmental, tax-exempt organization, and qualified merchant marine defined benefit plans. In the case of such plans, the defined benefit dollar limit is reduced in the case of retirement before age 62 and increased in the case of retirement after age 65. In addition, there is a floor on early retirement benefits. Pursuant to this floor, the minimum benefit payable at age 55 is $75,000.

In the case of a defined contribution plan, the limit on annual is additions if the lesser of (1) 25 percent of compensation [159] or (2) $30,000 (for 1999). In applying the limits on contributions and benefits, plans of the same employer are aggregated.

House Bill

The 100 percent of compensation defined benefit plan limit does not apply to multiemployer plans.

Effective date.—The House bill is effective for years beginning after December 31, 2000.

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[159] Another provision of the Senate amendment increases this limit to 100 percent of compensation.

Senate Amendment

Treatment of multiemployer plans

The 100 percent of compensation defined benefit plan limit does not apply to multiemployer plans. In addition, except in applying the defined benefit plan dollar limitation, multiemployer plans are not aggregated with other plans maintained by an employer contributing to the multiemployer plan in applying the limits on contributions and benefits.

The Senate amendment also applies the special rules for defined benefit plans of governmental employers, tax-exempt organizations, and qualified merchant marines to multiemployer plans.

Increase in early retirement floor for governmental, multiemployer, and other plans

The floor for reductions of the dollar limit prior to age 62 for defined benefit plans of governmental employers and tax-exempt organizations, qualified merchant marine plans and multiemployer plans is increased from $75,000 to 80 percent of the defined benefit dollar limit.

Effective date

The Senate amendment is effective for years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the House bill.

14. Rules for substantial owner benefits in terminated plans (sec. 363 of the Senate amendment and sec. 4022 of ERISA)

Present Law

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the 60 month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in depends on the number of years the plan has been in effect. The majority owner's guaranteed benefit is limited so that it may not be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets apply to substantial owners, other than majority owners, in the same manner as other participants.

Effective date.—The Senate amendment is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

15. Extension to international organizations of moratorium on application of certain nondiscrimination rules applicable to State and local government plans (sec. 368 of the Senate amendment, sec. 1505 of the Taxpayer Relief Act of 1997, and secs. 401(a) and 401(k) of the Code)

Present Law

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). A governmental plan maintained by an international organization that is exempt from taxation by reason of the International Organizations Immunities Act is not exempt from the nondiscrimination and minimum participation rules.

House Bill

No provision.

Senate Amendment

A governmental plan maintained by a tax-exempt international organization is exempt from the nondiscrimination and minimum participation rules.

Effective date.—The Senate amendment is effective for plan years beginning after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

16. Annual report dissemination (sec. 369 of the Senate amendment and sec. 104 of ERISA)

Present Law

Title I of ERISA generally requires the plan administrator of each employee pension benefit plan and each employee welfare benefit plan to file an annual report concerning the plan with the Secretary of Labor within 7 months after the end of the plan year. Within 9 months after the end of the plan year, the plan administrator generally must provide to each participant, and to each beneficiary receiving benefits under the plan, a summary of the annual report filed with the Secretary of Labor for the plan year.

House Bill

No provision.

Senate Amendment

Within 9 months after the end of each plan year, the plan administrator is required to make available for examination a summary of the annual report filed with the Secretary of Labor for the plan year. In addition, the plan administrator is required to furnish the summary to a participant, or to a beneficiary receiving benefits under the plan, upon request.

Effective date.—The Senate amendment is effective for reports for years beginning after December 31, 1998.

Conference Agreement

The conference agreement does not include the Senate amendment.

17. Clarification of exclusion for employer-provided transit passes (sec. 370 of the Senate amendment and sec. 132 of the Code)

Present Law

Qualified transportation fringe benefits provided by an employer are excluded from an employee's gross income and wages. Qualified transportation fringe benefits include parking, transit passes, and vanpool benefits. Up to $175 per month (for 1999) of employer-provided parking is excludable from income and up to $65 (for 1999) per month of employer-provided transit and vanpool benefits are excludable from income.

Qualified transportation benefits generally include a cash reimbursement by an employer to an employee. However, in the case of transit passes, a cash reimbursement is considered a qualified transportation fringe benefit only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer to the employee.

No amount is includible in the gross income of an employee merely because the employee is offered a choice between cash and any qualified transportation benefit (or a choice among such benefits).

House Bill

No provision.

Senate Amendment

The Senate amendment repeals the rule providing that cash reimbursements for transit benefits are excludable from income only if a voucher or similar item which may be exchanged only for a transit pass is not readily available for direct distribution by the employer.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

XIII. MISCELLANEOUS PROVISIONS

A. Expand Employer Reporting on Annual Wage and Tax Statements (sec. 1303 of the House bill and sec. 6051 of the Code)

Present Law

An employer must provide certain information annually to each employee in the form of a wage and tax statement ("Form W–2"). The information required to be included on such form includes the individual's name, address, social security number and a statement of total wages, tips, and other compensation for the year. The form must also include the amount of federal income tax withheld as well as the employee's share of social security and medicare taxes withheld for the year by the employer. There is no requirement that the form include a statement of the employer's share of social security and medicare taxes paid by the employer with respect to that individual.

House Bill

The House bill requires the Form W–2 to include a statement of social security and medicare taxes paid by the employer on behalf of each employee.

Effective date.—The House bill provision is effective with respect to Form W–2's with respect to remuneration paid after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision. However, the conferees intend that the Internal Revenue Service provide the employer's share of social security and medicare taxes to each employee, no less frequently than annually.

B. Survivor Benefits of Public Safety Officers Killed in The Line of Duty (sec. 1304 of the House bill and sec. 101 of the Code)

Present Law

The Taxpayer Relief Act of 1997 included a provision providing that an amount paid as a survivor annuity on account of the death of a public safety officer who is killed in the line of duty is excludable from income to the extent the survivor annuity is attributable to the officer's service as a law enforcement officer. The survivor annuity must be provided under a governmental plan to the surviving spouse (or former spouse) of the public safety officer or to a child of the officer. Public safety officers include law enforcement officers, firefighters, rescue squad or ambulance crew. The provision does not apply with respect to the death of a public safety officer if it is determined by the appropriate supervising authority that (1) the death was caused by the intentional misconduct of the officer or by the officer's intention to bring about the death, (2) the officer was voluntarily intoxicated at the time of death, (3) the officer was performing his or her duties in a grossly negligent manner at the time of death, or (4) the actions of the individual to whom payment is to be made were a substantial contributing factor to the death of the officer.

The provision applies to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

House Bill

The provision extends the present-law treatment of survivor annuities with respect to public safety officers killed in the line of duty to payments received in taxable years beginning after December 31, 1999, with respect to individuals dying on or before December 31, 1996.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

C. Income from Publicly Traded Partnerships Treated as Qualifying Income of Regulated Investment Companies (secs. 1311 and 1312 of the House bill and secs. 851(b) and 469(k) of the Code)

Present Law

A regulated investment company ("RIC") generally is treated as a conduit for Federal income tax purposes. In computing its taxable income, a RIC deducts dividends paid to its shareholders to achieve conduit treatment (sec. 852(b)). In order to qualify for con-

duit treatment, a RIC must be a domestic corporation that, at all times during the taxable year, is registered under the Investment Company Act of 1940 as a management company or as a unit investment trust, or has elected to be treated as a business development company under that Act (sec. 851(a)). In addition, the corporation must elect RIC status, and must satisfy certain other requirements (sec. 851(b)).

One of the requirements is that at least 90 percent of its gross income is derived from dividends, interest, payments with respect to securities loans, and gains from the sale or other disposition of stock or securities or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies. Income derived from a partnership is treated as meeting this requirement only to the extent such income is attributable to items of income of the partnership that would meet the requirement if realized by the RIC in the same manner as realized by the partnership (the "look-through" rule for partnership income). Under present law, no distinction is made under this rule between a publicly traded partnership and any other partnership.

Present law provides that a publicly traded partnership means a partnership, interests in which are traded on an established securities market, or are readily tradable on a secondary market (or the substantial equivalent thereof). In general, a publicly traded partnership is treated as a corporation (sec. 7704(a)), but an exception to corporate treatment is provided if 90 percent or more of its gross income is interest, dividends, real property rents, or certain other types of qualifying income (sec. 7704(c) and (d)).

A special rule for publicly traded partnerships applies under the passive loss rules. The passive loss rules limit deductions and credits from passive trade or business activities (sec. 469). Deductions attributable to passive activities, to the extent they exceed income from passive activities, generally may not be deducted against other income. Deductions and credits that are suspended under these rules are carried forward and treated as deductions and credits from passive activities in the next year. The suspended losses from a passive activity are allowed in full when a taxpayer disposes of his entire interest in the passive activity to an unrelated person. The special rule for publicly traded partnerships provides that the passive loss rules are applied separately with respect to items attributable to each publicly traded partnership (sec. 469(k)). Thus, income or loss from the publicly traded partnership is treated as separate from income or loss from other passive activities.

House Bill

The House bill modifies the 90 percent test with respect to income of a RIC to include income derived from an interest in a publicly traded partnership. The provision also modifies the lookthrough rule for partnership income of a RIC so that it applies only to income from a partnership other than a publicly traded partnership.

The provision provides that the special rule for publicly traded partnerships under the passive loss rules (requiring separate treat-

ment) applies to a RIC holding an interest in a publicly traded partnership, with respect to items attributable to the interest in the publicly traded partnership.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

D. Equalize the Tax Treatment of Oversized "Clean Fuel" Vehicles and Electric Vehicles (sec. 1313 of the House bill and sec. 30 and 179A of the Code)

Present Law

Taxpayers may claim a credit of 10 percent of the cost of an electric vehicle up to a maximum credit of $4,000 (sec. 30). Taxpayers may claim an immediate deduction (expensing) for up to $50,000 of the cost of a qualified clean-fuel vehicle which is a truck or van with a gross vehicle weight greater than 13 tons or a bus with a seating capacity of at least 20 adults (sec. 179A). For the purposes of the deduction permitted under section 179A, electric trucks, vans, or buses are not qualified clean fuel vehicles.

House bill

The House bill provides that an electric truck or van with a gross vehicle weight rating greater than 13 tons or an electric bus which has seating capacity of at least 20 adults is a qualified clean fuel vehicle for which the taxpayer may expense up to $50,000 of cost and that such vehicles are not eligible for the electric vehicle credit.

Effective date.—The provision is effective for vehicles placed in service after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

Effective date.—The provision is effective for vehicles placed in service after December 31, 1999.

E. Nuclear Decommissioning Costs (sec. 1314 of the House bill and sec. 468A of the Code)

Present Law

Special rules dealing with nuclear decommissioning reserve funds were adopted by Congress in the Deficit Reduction Act of 1984 ("1984 Act") when tax issues regarding the time value of money were addressed generally. Under general tax accounting

rules, a deduction for accrual basis taxpayers generally is deferred until there is economic performance for the item for which the deduction is claimed. However, the 1984 Act contains an exception to those rules under which a taxpayer responsible for nuclear power plant decommissioning may elect to deduct contributions made to a qualified nuclear decommissioning fund for future payment costs. Taxpayers who do not elect this provision are subject to the general rules in the 1984 Act.

A qualified decommissioning fund is a segregated fund established by the taxpayer that is used exclusively for the payment of decommissioning costs, taxes on fund income, payment of management costs of the fund, and making investments. The fund is prohibited from dealing with the taxpayer that established the fund. The income of the fund is taxed at a reduced rate of 20 percent [160] for taxable years beginning after December 31, 1995.

Contributions to the fund are deductible in the year made to the extent that these amounts were collected as part of the cost of service to ratepayers. Withdrawal of funds by the taxpayer to pay for decommissioning expenses are included in income at that time, but the taxpayer also is entitled to a deduction at that time for decommissioning expenses as economic performance for those costs occurs.

A taxpayer's contributions to the fund may not exceed the amount of nuclear decommissioning costs included in the taxpayer's cost of service for ratemaking purposes for the taxable year. Additionally, in order to prevent accumulations of funds over the remaining life of a nuclear power plant in excess of those required to pay future decommissioning costs and to ensure that contributions to the funds are not deducted more rapidly than level funding, taxpayers must obtain a ruling from the IRS to establish the maximum contribution that may be made to the fund.

If the decommissioning fund fails to comply with the qualification requirements or when the decommissioning is substantially completed, the fund's qualification may be terminated, in which case the amounts in the fund must be included in income of the taxpayer.

A qualified decommissioning fund may be transferred in connection with the sale, exchange or other transfer of the nuclear power plant to which it relates. If the transferee is a regulated public utility and meets certain other requirements, the transfer will be treated as a nontaxable transaction. No gain or loss will be recognized on the transfer of the qualified decommissioning fund and the transferee will take the transferor's basis in the fund. [161] The transferee is required to obtain a new ruling amount from the IRS, or accept a discretionary determination by the IRS. [162] However, if the transferee does not qualify to continue the qualified de-

[160] As originally enacted in 1984, the fund paid tax on its earnings at the top corporate rate. Also, as originally enacted, the funds in the trust could be invested only in certain low risk investments. Subsequent amendments to the provision have reduced the rate of tax on the fund to 20 percent, and removed the restrictions on the types of permitted investments that the fund can make.

[161] Treas. Regs. sec. 1.468A–6.

[162] Treas. Regs. sec. 1.468A–6(f).

commissioning fund, the balance in the fund will be treated as distributed (and thus taxable) at the time of the transfer.

State and Federal regulators may require utilities to set aside funds for nuclear decommissioning purposes in excess of the amount allowed as a deductible contribution to a qualified decommissioning fund. In addition, the taxpayer may have set aside funds prior to the effective date of the qualified decommissioning fund rules. In some cases, a deduction may have been taken for such amounts at the time they were set aside.[163] These nonqualified funds are not eligible for the special rules that apply to qualified decommissioning funds. Since 1984, no deduction has been allowed with respect to the contribution or segregation of nonqualified funds, and the income on nonqualified funds is taxed to the taxpayer at the taxpayer's marginal rate.

House Bill

The cost of service requirement for deductible contributions to nuclear decommissioning funds is repealed. Taxpayers, including unregulated taxpayers, are allowed a deduction for amounts contributed to a qualified nuclear decommissioning fund. As under current law, however, the maximum contribution and deduction for a taxable year can not exceed the IRS ruling amount for that year.

The provision also clarifies the Federal income tax treatment of the transfer of qualified nuclear decommissioning funds. No gain or loss is recognized to the transferor or the transferee as a result of the transfer of a qualified fund in connection with the transfer of the power plant with respect to which the fund was established.

The provision provides an election to transfer the balance of certain nonqualified funds to qualified fund. Any portion of the amount transferred that has not previously been deducted is allowed as a deduction over the remainder of the useful life of the nuclear power plant (as determined for the purpose of the ruling amount) beginning with the first taxable year that begins after 2001. If a qualified fund that has received a transfer from a nonqualified fund is transferred to another person, that person will be entitled to the deduction at the same time and in the same manner as the transferor. Thus, if the transferor was not subject to tax at the time and thus would have been unable to utilize the deduction, the transferee will similarly not be able to utilize the deduction. A taxpayer is not considered to have a basis in any qualified nuclear decommissioning fund.

Nonqualified funds eligible to be transferred to a qualified fund are funds that have been irrevocably set aside pursuant to the requirements of a state of Federal agency exclusively for the purpose of funding the decommissioning of the taxpayer's nuclear power plant. Funds that constitute a "prepaid decommissioning fund" or "external sinking trust fund" that would qualify for the purpose of providing financial assurance that funds will be available for the decommisioning process under 10 CFR 50.75 are expected to meet the definition of nonqualified funds for this purpose.

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[163] Prior to July 17, 1984 (the date of enactment of the Deficit Reduction Act of 1984), accrual basis taxpayers could deduct items without regard to the time the items were economically performed. Some taxpayers may have taken the position that amounts for nuclear decommissioning were deductible prior to July 17, 1984.

A new ruling amount must be obtained following the transfer of nonqualified funds to a qualified fund.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

F. Permit Consolidation of Life and Nonlife Insurance Companies (sec. 1315 of the House bill, sec. 1113 of the Senate amendment, and secs. 1504(b)(2) and 1504(c) of the Code)

Present Law

Under present law, an affiliated group of corporations means one or more chains of includible corporations connected through stock ownership with a common parent corporation (sec. 1504(a)(1)). The stock ownership requirement consists of an 80-percent voting and value test. In general, an affiliated group of corporations may file a consolidated tax return for Federal income tax purposes.

Life insurance companies (subject to tax under section 801) generally are not treated as includible corporations, and therefore may not be included in a consolidated return of an affiliated group including nonlife-insurance companies, unless the common parent of the group elects to treat the life insurance companies as includible corporations (sec. 1504(c)(2)).

Under the election to treat life insurance companies as includible corporations of an affiliated group, two special 5-year limitation rules apply. The first 5-year rule provides that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed (sec. 1504(c)(2)). The second 5-year rule provides that any net operating loss of a nonlife-insurance member of the group may not offset the taxable income of a life insurance member for any of the first 5 years the life and nonlife-insurance corporations have been members of the same affiliated group (sec. 1503(c)(2)). This rule applies to nonlife losses for the current taxable year or as a carryover or carryback.

A separate 35-percent limitation also applies under the election to treat life insurance companies as includible corporations of an affiliated group (sec. 1503(c)(1)). This rule provides that if the nonlife-insurance members of the group have a net operating loss, then the amount of the loss that is not absorbed by carrybacks against the nonlife-insurance members' income may offset the life insurance members' income only to the extent of the lesser of: (1) 35 percent of the amount of the loss; or (2) 35 percent of the life insurance members' taxable income. The unused portion of the loss is available as a carryover and is added to subsequent-year losses, subject to the same 35-percent limitation.

House Bill

The House bill repeals the two 5-year limitation rules under the election to treat life insurance companies as includible corporations of an affiliated group. The provision also repeals the rule that a life insurance corporation is not an includible corporation unless the common parent makes an election to treat life insurance companies as includible corporations. Thus, under the provision, a life insurance company is treated as an includible corporation starting with the first taxable year for which it becomes a member of the affiliated group and otherwise meets the definition of an includible corporation. In addition, any net operating loss of a nonlife-insurance member of the group can offset the taxable income of a life insurance member starting with the first taxable year for which it becomes a member of the affiliated group and otherwise meets the definition of an includible corporation. The provision retains the 35-percent limitation of present law with respect to any life insurance company that is an includible corporation of an affiliated group.

Effective date.—The provision is effective for taxable years beginning after December 31, 2004. To the extent that a consolidated net operating loss is created or increased by the provision, the loss may not be carried back to a taxable year beginning before January 1, 2005. In addition, no affiliated group terminates solely by reason of the provision. The provision waives the 5-year waiting period for reconsolidation under section 1504(a)(3), in the case of any corporation that was previously an includible corporation, but was subsequently deemed not to be an includible corporation as a result of becoming a subsidiary of a corporation that was not an includible corporation by reason of the 5-year rule of section 1504(c)(2) (providing that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed).

Senate Amendment

The Senate amendment repeals the 5-year limitation rule relating to consolidation under the election to treat life insurance companies as includible corporations of an affiliated group. The provision also repeals the rule that a life insurance corporation is not an includible corporation unless the common parent makes an election to treat life insurance companies as includible corporations. Thus, under the provision, a life insurance company is treated as an includible corporation starting with the first taxable year for which it becomes a member of the affiliated group and otherwise meets the definition of an includible corporation. However, as under present law, any net operating loss of a nonlife-insurance member of the group may not offset the taxable income of a life insurance member for any of the first five years the life and nonlife-insurance corporations have been members of the same affiliated group. The provision retains the 35-percent limitation of present law with respect to any life insurance company that is an includible corporation of an affiliated group.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000. To the extent that a consolidated

net operating loss is created or increased by the provision, the loss may not be carried back to a taxable year beginning before January 1, 2001. In addition, no affiliated group terminates solely by reason of the provision. The provision waives the 5-year waiting period for reconsolidation under section 1504(a)(3), in the case of any corporation that was previously an includible corporation, but was subsequently deemed not to be an includible corporation as a result of becoming a subsidiary of a corporation that was not an includible corporation by reason of the 5-year rule of section 1504(c)(2) (providing that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed).

Conference Agreement

The conference agreement follows the Senate amendment. The conference agreement also follows the House bill with respect to repeal of the second 5-year rule (which provides that any net operating loss of a nonlife-insurance member of the group may not offset the taxable income of a life insurance member for any of the first 5 years the life and nonlife-insurance corporations have been members of the same affiliated group (sec. 1503(c)(2)), with a modification as to the effective date of repeal of the second 5-year rule. Under the conference agreement, repeal of the second 5-year rule is effective for taxable years beginning after December 31, 2005.

Effective date.—The repeal of the first 5-year rule and the repeal of the election to treat a life insurance company as an includible corporation are effective for taxable years beginning after December 31, 2000. The repeal of the second 5-year rule (sec. 1503(c)(2)) is effective for taxable years beginning after December 31, 2005. To the extent that a consolidated net operating loss is created or increased by the provision, the loss may not be carried back to a taxable year beginning before January 1, 2006. In addition, no affiliated group terminates solely by reason of the provision. The provision waives the 5-year waiting period for reconsolidation under section 1504(a)(3), in the case of any corporation that was previously an includible corporation, but was subsequently deemed not to be an includible corporation as a result of becoming a subsidiary of a corporation that was not an includible corporation by reason of the 5-year rule of section 1504(c)(2) (providing that a life insurance company may not be treated as an includible corporation until it has been a member of the group for the 5 taxable years immediately preceding the taxable year for which the consolidated return is filed).

G. Consolidate Code Provisions Governing the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund (sec. 1321 of the House bill and secs. 9507 and 9508 of the Code)

Present Law

Present law includes two separate Trust Funds to finance similar ground and water cleanup programs related to hazardous sub-

stances. These funds are the Hazardous Substance Superfund (the "Superfund") and the Leaking Underground Storage Tank Trust Fund (the "LUST Trust Fund"). Amounts in both Trust Funds are available as provided in cross-referenced authorization and appropriations Acts.

House Bill

The Code provisions governing the Superfund and the LUST Trust Fund are consolidated into a single Environmental Remediation Trust Fund (the "Environmental Trust Fund"). Amounts in the consolidated Trust Fund (i.e., all amounts in both of the present-law Trust Funds) are available for expenditure, as provided in appropriations Acts, for the combined purposes of the two present-law Trust Funds, as of July 12, 1999.

Provisions similar to those currently included in the Highway Trust Fund, the Aquatic Resources Trust Fund, and the Vaccine Injury Compensation Trust Fund clarifying that expenditures from the Environmental Trust Fund may occur only as provided in the Code are incorporated into the new Trust Fund statute, notwithstanding provisions of any other Act (including subsequently enacted non-revenue Act legislation).

Effective date.—The provision is effective on October 1, 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification providing that the LUST and Superfund provisions of the new Environmental Remediation Trust Fund will be divided into separate accounts upon future enactment of Superfund authorizing legislation. Upon enactment of such authorizing legislation, the LUST Account will be reimbursed from the Superfund Account for any amounts attributable to the LUST excise tax (and interest thereon) used to finance Superfund programs.

H. Repeal Certain Excise Taxes on Rail Diesel Fuel and Inland Waterway Barge Fuels (sec. 1322 of the House bill, sec. 1101 of the Senate amendment, and secs. 4041 and 4042 of the Code)

Present Law

Under present law, diesel fuel used in trains is subject to a 4.4-cents-per-gallon excise tax. Revenues from 4.3 cents per gallon of this excise tax are retained in the General Fund of the Treasury. The remaining 0.1 cent per gallon is deposited in the Leaking Underground Storage Tank ("LUST") Trust Fund.

Similarly, fuels used in barges operating on the designated inland waterways system is subject to a 4.3-cents-per-gallon General Fund excise tax. This tax is in addition to the 20.1-cents-per-gallon tax rates that are imposed on fuels used in these barges to fund the Inland Waterways Trust Fund and the Leaking Underground Storage Tank Trust Fund.

In both cases, the 4.3-cents-per-gallon excise tax rates are permanent. The LUST tax is scheduled to expire after March 31, 2005.

House Bill

The 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is repealed. In addition, the 4.3-cents-per-gallon General Fund excise tax rates on diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system is repealed.

Effective date.—The repeal of the 0.1-cent-per-gallon LUST tax on diesel fuel used in trains is effective on October 1, 1999. The repeal of the 4.3-cents-per-gallon excise taxes on train diesel and inland waterway barge fuels is effective after September 30, 2003.

Repeal of these taxes is contingent upon enactment as part of the bill of a separate provision that consolidates the Code provisions governing the Hazardous Substance Superfund and the Leaking Underground Storage Tank Trust Fund into an Environmental Remediation Trust Fund.

Senate Amendment

The Senate amendment is the same as the House bill.

Effective date.—The provision of the Senate amendment is effective on October 1, 2000.

Conference Agreement

The conference agreement follows the House bill.

I. Repeal Excise Tax on Fishing Tackle Boxes (sec. 1323 of the House bill and sec. 4162 of the Code)

Present Law

Under present law, a 10-percent manufacturer's excise tax is imposed on specified sport fishing equipment. Examples of taxable equipment include fishing rods and poles, fishing reels, artificial bait, fishing lures, line and hooks, and fishing tackle boxes. Revenues from the excise tax on sport fishing equipment are deposited in the Sport Fishing Account of the Aquatic Resources Trust Fund. Monies in the fund are spent, subject to an existing permanent appropriation, to support Federal-State sport fish enhancement and safety programs.

In addition to the revenues from the sport fishing equipment excise tax, the Sport Fishing Account also receives revenues from excise taxes imposed on motorboat gasoline and special fuels. These motorboat fuels are subject to an excise tax totaling 18.4 cents per gallon. Of this amount, 11.5 cents per gallon is dedicated to the Sport Fishing Account. This amount is scheduled to increase to 13 cents per gallon (October 1, 2001-September 30, 2003) and to 13.5 cents per gallon (beginning October 1, 2003). The balance of these motorboat fuels taxes (other than 0.1 cent per gallon which is dedicated to the Leaking Underground Storage Tank Trust Fund) is retained in the General Fund.

House Bill

The excise tax on fishing tackle boxes is repealed.

Effective date.—The provision is effective beginning 30 days after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill, with a modification increasing by 0.2 cent per gallon the amount of the motorboat gasoline and special motor fuels taxes that are dedicated to the Sport Fishing Account of the Aquatic Resources Trust Fund. Thus, the amount transferred to that Account will be 11.7 cents per gallon (through September 30, 2001), 13.2 cents per gallon (October 1, 2001-September 30, 2003), and 13.7 cents per gallon thereafter.

Effective date.—The conference agreement follows the House bill with regard to repeal of the fishing tackle excise tax; the modification relating to transfer of the motorboat fuels taxes is effective for taxes received beginning 30 days after the date of enactment.

J. Modify Excise Tax on Arrow Components and Accessories (sec. 1324 of the House bill, sec. 1109 of the Senate amendment, and sec. 4161 of the Code)

Present Law

An 12.4 percent excise tax is imposed on the sale by a manufacturer or importer of any shaft, point, nock, or vane designed for use as part of an arrow which (1) is over 18 inches long, or (2) is designed for use with a taxable bow (if shorter than 18 inches). An 11-percent tax is imposed on certain bows and on certain accessories for taxable bows and arrows.

House Bill

The House bill makes two modifications to the excise tax on arrows and arrow accessories. First, the bill extends the 12.4-percent tax on arrow components to inserts and outserts designed for use with taxable arrows. Inserts and outserts are defined as articles used to attach a point to an arrow shaft. Second, the bill reclassifies "broadheads," or arrow points designed for hunting fish or large animals, as arrow accessories subject to the 11-percent tax rather than arrow points subject to the 12.4-percent tax (as under present law).

Effective date.—The provisions apply to sales by manufacturers beginning on the first day of the first calendar quarter that begins more than 30 days after the bill's enactment.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

K. Entrepreneurial Equity Capital Formation ("SSBICS") (secs. 1341–1347 of the House bill and secs. 851, 1044 and 1202 of the Code)

Present Law

Under present law, a taxpayer may elect to roll over without payment of tax any capital gain realized upon the sale of publicly-traded securities where the taxpayer uses the proceeds from the sale to purchase common stock in a specialized small business investment company ("SSBIC") within 60 days of the sale of the securities. The maximum amount of gain that an individual may roll over under this provision for a taxable year is limited to the lesser of (1) $50,000 or (2) $500,000 reduced by any gain previously excluded under this provision. For corporations, these limits are $250,000 and $1 million.

In addition, under present law, an individual may exclude 50 percent of the gain[164] from the sale of qualifying small business stock held more than five years. An SSBIC is automatically deemed to satisfy the active business requirement which a corporation must satisfy to qualify its stock for the exclusion.

Regulated investment companies ("RICs") are entitled to deduct dividends paid to shareholders. To qualify for the deduction, 90 percent of the company's income must be derived from dividends, interest and other specified passive income, the company must distribute 90 percent of its investment income, and at least 50 percent of the value of its assets must be invested in certain diversified investments.

For purposes of these provisions, an SSBIC means any partnership or corporation that is licensed by the Small Business Administration under section 301(d) of the Small Business Investment Act of 1958 (as in effect on May 13, 1993). SSBICs make long-term loans to, or equity investments in, small businesses owned by persons who are socially or economically disadvantaged.

House Bill

Under the House the tax-free rollover provision is expanded by (1) extending the 60-day period to 180 days, (2) making preferred stock (as well as common stock) in an SSBIC an eligible investment, and (3) increasing the lifetime caps to $750,000 in the case of an individual and to $2 million in the case of a corporation, and repealing the annual caps.

The House also provides that an SSBIC that is organized as a corporation may convert to a partnership without imposition of a tax to either the corporation or its shareholders, by transferring its assets to a partnership in which it holds at least an 80-percent interest and then liquidating. The corporation is required to dis-

[164] The portion of the capital gain included in income is subject to a maximum regular tax rate of 28 percent, and 42 percent of the excluded gain is a minimum tax preference.

tribute all its earnings and profits before liquidating. The transaction must take place within 180 days of enactment of the bill. The partnership will be liable for a tax on any "built-in" gain in the assets transferred by the corporation at the time of the conversion.

The 50-percent exclusion for gain on the sale of qualifying small business stock is increased to 60 percent where the taxpayer, or a pass-through entity in which the taxpayer holds an interest, sells qualifying stock of an SSBIC.

For purposes of determining status as a RIC eligible for the dividends received deduction, the proposal would treat income derived by a SSBIC from its limited partner interest in a partnership whose business operations the SSBIC does not actively manage as income qualifying for the 90-percent test; would deem the SSBIC to satisfy the 90-percent distribution requirement if it distributes all its income that it is permitted to distribute under the Small Business Investment Act of 1958; and would deem the RIC diversification of assets requirement to be met to the extent the SSBIC's investments are permitted under that Act.

Effective date.—The rollover and small business stock provisions of the proposal are effective for sales after date of enactment. The RIC provisions are effective for taxable years beginning after date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

L. Tax Treatment of Alaska Native Settlement Trusts (sec. 1352 of the House bill, sec. 1102 of the Senate amendment, and new sec. 646 of the Code)

Present Law

An Alaska Native Settlement Corporation ("ANC") may establish a Settlement Trust ("Trust") under section 39 of the Alaska Native Claims Settlement Act ("ANCSA")[165] and transfer money or other property to such Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the ANC, to promote the health, education and welfare of the beneficiaries and preserve the heritage and culture of Alaska Natives.

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

The Internal Revenue Service has indicated that contributions to a Trust constitute distributions to the beneficiary-shareholders at the time of the contribution and are treated as dividends to the extent of earnings and profits as provided under section 301 of the

[165] 43 U.S.C. 1601 et. seq.

Code. The Trust and its beneficiaries are taxed according to the rules of Subchapter J of the Code.

House Bill

An Alaska Native Corporation may establish a Trust under section 39 of ANCSA and if the Trust makes an election for its first taxable year ending after December 31, 1999, no amount will be includible in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust. The earnings and profits of the ANC are not reduced at the time of a conveyance to the Trust, but only after all earnings of the Trust have been distributed, and subsequent distributions to beneficiaries are made from the original principal conveyed.

Qualification of the Trust for tax-free conveyances terminates if interests in the Trust or in the ANC may be transferred or exchanged to a person in a manner that would not be permitted under ANCSA if the trust interests were Settlement Common Stock (generally, to anyone other than an Alaska Native).

The final distributions of principal, which reduce earnings and profits of the ANC, are treated as ordinary income to the beneficiaries and may be reported on Form 1099 rather than form K–1. If annualized distributions exceed the sum of the standard deduction plus the personal exemption, withholding is required. All other Trust earnings and distributions are treated under present law.

Effective date.—The provision is effective for contributions after, and taxable years of Trusts ending after, December 31, 1999.

Senate Amendment

The Senate amendment follows the House bill, with additions and modifications. Under the Senate amendment, unless the Trust fails to meet the other requirements of the provision, the Trust will be permitted to accumulate up to 45 percent of its income each year without tax to the Trust or the beneficiaries on that income. To qualify for this treatment, an electing Trust must distribute at least 55 percent of its adjusted taxable income for the year. If the Trust fails to meet this distribution requirement, tax at trust rates is imposed on the amount of the failure.

Every distribution by the Trust to beneficiaries is taxable as ordinary income to the beneficiaries. Reporting to beneficiaries for the future could be made on form 1099 rather than on form K–1. Distributions to beneficiaries would be subject to withholding to the extent such distributions, on an annualized basis, exceed the sum of the standard deduction and the personal exemption.

Certain additional restrictions apply. If the beneficial interests in the Trust may be sold or exchanged to a person in a manner that would not be permitted under ANCSA if the interests were Settlement Common Stock (generally, to a person other than an Alaska Native), then the value of all assets of the Trust that have not been distributed at the end of the taxable year of the Trust is subject to a tax at the highest individual tax rate; thereafter all amounts retained that were subject to that tax are treated as corpus under subchapter J. Also, if the shares of the ANC may be sold

or exchanged to a person in such a manner, the Trust may continue in existence without an excise tax only if no new contributions are made to the Trust and the beneficial interests in the Trust cannot be sold or exchanged in such a manner.

Apart from these rules, the Trust and its beneficiaries would be taxed according to the provisions of subchapter J of the Code.

Effective date.—The effective date is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill.

M. Increase Joint Committee on Taxation Refund Review Threshold to $2 Million (sec. 1353 of the House bill, sec. 1110 of the Senate amendment, and sec. 6405 of the Code)

Present Law

No refund or credit in excess of $1,000,000 of any income tax, estate or gift tax, or certain other specified taxes, may be made until 30 days after the date a report on the refund is provided to the Joint Committee on Taxation (sec. 6405). A report is also required in the case of certain tentative refunds. Additionally, the staff of the Joint Committee on Taxation conducts post-audit reviews of large deficiency cases and other select issues.

House Bill

The provision increases the threshold above which refunds must be submitted to the Joint Committee on Taxation for review from $1,000,000 to $2,000,000. The staff of the Joint Committee on Taxation would continue to exercise its existing statutory authority to conduct a program of expanded post-audit reviews of large deficiency cases and other select issues, and the IRS is expected to cooperate fully in this expanded program.

Effective date.—The provision is effective on the date of enactment, except that the higher threshold does not apply to a refund or credit with respect to which a report was made before the date of enactment.

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

N. Clarification of Depreciation Study (sec. 1354 of the House bill)

Present Law

The Secretary of the Treasury (or his delegate) is directed to conduct a comprehensive study of the recovery periods and depreciation methods under section 168 of the Code, and to provide rec-

ommendations for determining such periods and methods in a more rational manner. The Secretary of the Treasury (or his delegate) is directed to submit the results of the study and recommendations to the House Ways and Means and Senate Finance Committees by March 31, 2000.

House Bill

The Secretary of the Treasury (or his delegate) is directed to include a study of such periods and methods applicable to section 1250 property used in connection with a franchise (within the meaning of section 1253) and owned by the franchisee in the study of recovery periods and depreciation methods under section 168 of the Code that is due to be submitted to the House Ways and Means and Senate Finance Committees by March 31, 2000.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the provision of the House bill. Nonetheless, the conferees expect that the study will include an examination of the depreciation issues raised in the House bill and the Senate amendment, including leasehold improvements and section 1250 property used in connection with a franchise.

O. Tax Court Provisions

1. Tax Court filing fee (sec. 1361 of the House bill and sec. 7451 of the Code)

Present Law

Section 7451 authorizes the Tax Court to impose a fee of up to $60 for the filing of any petition "for the redetermination of a deficiency or for a declaratory judgment under part IV of this subchapter or under section 7428 or for judicial review under section 6226 or section 6228(a)." The statute does not specifically authorize the Tax Court to impose a filing fee for the filing of a petition for review of the IRS's failure to abate interest under section 6404 or for administrative costs under section 7430. The practice of the Tax Court is to impose a $60 filing fee in all cases commenced by petition.[166]

House Bill

Under the House bill, section 7451 is amended to provide that the Tax Court is authorized to charge a filing fee of up to $60 in all cases commenced by the filing of a petition.

Effective date.—The provision is effective on the date of enactment.

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[166] See Rule 20(a) of the Tax Court Rules of Practice and Procedure.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

2. Use of practitioner fee (sec. 1362 of the House bill and sec. 7475 of the code)

Present Law

Section 7475 authorizes the Tax Court to impose on practitioners a fee of up to $30 per year and permits these fees to be used to employ independent counsel to pursue disciplinary matters.

House Bill

The House bill provides that Tax Court fees imposed on practitioners also are available to provide services to pro se taxpayers.

Effective date.—The provision is effective on the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

3. Tax Court authority to apply equitable recoupment (sec. 1363 of the House bill and sec. 6214 of the code)

Present Law

Equitable recoupment is a common-law equitable principle which permits the defensive use of an otherwise time-barred claim to reduce or defeat an opponent's claim if both claims arise from the same transaction. U.S. District Courts and the U.S. Court of Federal Claims, the two Federal tax refund forums, may apply equitable recoupment in deciding tax refund cases.[167] In *Estate of Mueller* v. *Commissioner*,[168] the Tax Court held that it may apply equitable recoupment in deciding cases over which it has jurisdiction. However, the Court of Appeals for the Sixth Circuit recently held that the Tax Court may not apply the doctrine of equitable recoupment.[169]

House Bill

Under the House bill, section 6214(b) is amended to provide that the Tax Court may apply the principle of equitable recoupment to the same extent that it may be applied in Federal

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[167] See *Stone* v. *White*, 301 U.S. 532 (1937); *Bull* v. *United States*, 295 U.S. 247 (1935).

[168] 101 T.C. 551 (1993).

[169] See *Estate of Mueller* v. *Commission*, 153 F.3d 302 (6th Cir. 1998), cert. denied, 67 U.S.L.W. 3525 (U.S. Feb. 22, 1999) (No. 98–794). In an earlier case, the Supreme Court specifically reserved ruling on whether the Tax Court may apply equitable recoupment in a case over which it otherwise has jurisdiction. *United States* v. *Dalm*, 494 U.S. 596, 611 n.8 (1990).

civil tax cases by the U.S. District Courts of U.S. Court of Federal Claims.[170]

Effective date.—The provision is effective for any action or proceeding in the Tax Court with respect to which a decision has not become final as of the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the House bill.

P. Allow Certain Wholesale Distributors and Control State Entities to Elect To Be Treated as Distilled Spirits Plants Operators (sec. 1371–1377 of the House bill and secs. 5002, 5005, 5011, 5113, 5171, 5178, 5212, 5214, 5232, 5551, 5601, 5602, and 5684 of the Code)

Present Law

Distilled spirits produced or imported (or brought) into the United States are subject to a $13.50 per proof gallon excise tax. A proof gallon is a U.S. gallon consisting of 50 percent alcohol. The tax is imposed on removal of the distilled spirits from the distillery where produced in the case of domestically produced spirits. In the case of distilled spirits imported in bulk and transferred to a U.S. distillery, the tax is imposed upon removal from the distillery. In the case of bottled distilled spirits imported into the United States, the tax is imposed on removal of the spirits from customs custody or the first customs bonded warehouse in the United States (or in a foreign trade zone) to which the spirits are transferred.

House Bill

The House bill allows certain wholesale dealers and certain control State entities[171] (collectively, "bonded dealers") to elect to become distilled spirits taxpayers. Code regulations relating to operation of distilled spirits plants, other than requirements directly related to production and bottling of distilled spirits, are extended to qualified bonded dealers. As under present law, excise tax will be determined in all cases upon removal from the distilled spirits plant or upon importation; however, in the case of distilled spirits transferred to a bonded dealer, payment of the tax will be delayed until the distilled spirits are removed from the bonded dealer's premises. All removals (including removals to other bonded dealers) of non-tax-paid distilled spirits by bonded dealers are subject to tax.

Operators of distilled spirits plants and importers will be required to certify to bonded dealers the amount of tax due with respect to all distilled spirits transferred without payment of tax. Bonded dealers are liable for the full amount of tax reflected in the

[170] No implication is intended with respect to whether the Tax court has the authority to continue to apply other equitable principles in deciding matters over which it has jurisdiction.

[171] A control state entity is a State or political subdivision of a State in which only the state or political subdivision is allowed by law to perform distilled spirits operations.

certification supplied by the operator of distilled spirits plant from which the spirits are transferred without payment of tax. Distilled spirits plant operators remain liable for any understatement of tax on the certifications.

Only wholesale distributors or control State entities having gross receipts from the sale of distilled spirits within the United States in the 12-month period preceding the date on which the election is made equal to or exceeding $10 million may qualify as bonded dealers. Additionally, except in the case of control State entities, bonded dealers qualify only if they sell distilled spirits exclusively to other wholesale distributors (including other bonded dealers) or to independent retail dealers. Retail dealers, other than control State entities, are not permitted to be bonded dealers. For purposes of this rule, a wholesale distributor is treated as a retail dealer if the dealer directly, or indirectly through common ownership by or of a third party, more than 10 percent of a retail dealer.

As a condition of being granted and retaining bonded dealers status, electing wholesale distributors and control State entities are subject to a new Federal excise surtax equal to 1.5 percent of their liability for distilled spirits tax. The surtax is imposed in the same manner as the present-law distilled spirits tax; payment of the tax must be made in the same manner as the underlying distilled spirits excise tax. The surtax will expire after December 31, 2010.

Studies.—The House bill directs the Treasury Department to study and report to the House Committee on Ways and Means and the Senate Committee on Finance whether administrative efficiencies could result from cooperative tax collection agreements between the Federal Government and States. This report is due no later than the date which is one year after the bill's enactment. The House bill further directs the Treasury Department to study and report to these two Committees, the effect allowing bonded dealers to receive non-tax-paid distilled spirits on taxpayer compliance with the provisions of Code section 5010 (the "wine and flavors credits"). This report is due no later than June 1, 2002.

Effective date.—The provision is effective beginning on the first day of the first calendar quarter that begins at least 120 days after the bill's enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

Q. Simplify the Active Trade or Business Requirement for Tax-Free Spin-offs (sec. 1107 of the Senate amendment and sec. 355 of the Code)

Present Law

A corporation generally is required to recognize gain on the distribution of property (including stock of a subsidiary) to its shareholders as if such property had been sold for its fair market

value. An exception to this rule is where the distribution of the stock of a controlled corporation satisfies the requirements of section 355. Among the requirements that must be satisfied in order to qualify for tax-free treatment under section 355 is that, immediately after the distribution, both the distributing corporation and the controlled corporation must be engaged in the active conduct of a trade or business (sec. 355(b)(1)).[172] For this purpose, a corporation is engaged in the active conduct of a trade or business only if (1) the corporation is directly engaged in the active conduct of a trade or business, or (2) if the corporation is not directly engaged in an active trade or business, then substantially all of its assets consist of stock and securities of a corporation it controls that is engaged in the active conduct of a trade or business (sec. 355(b)(2)(A)).

In determining whether a corporation satisfies the active trade or business requirement, the Internal Revenue Service's position for advance ruling purposes is that the value of the gross assets of the trade or business being relied on must constitute at least five percent of the total fair market value of the gross assets of the corporation directly conducting the trade or business.[173] However, if the corporation is not directly engaged in an active trade or business, then the "substantially all" test requires that at least 90 percent of the value of the corporation's gross assets consist of stock and securities of a controlled corporation that is engaged in the active conduct of a trade or business.[174]

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the "substantially all" test, and instead, applies the active trade or business requirement on an affiliated group basis. In applying the active trade or business test to an affiliated group, each separate affiliated group (immediately after the distribution) must satisfy the requirement. For the distributing corporation, the separate affiliated group consists of the distributing corporation as the common parent and all corporations connected with the distributing corporation through stock ownership described in section 1504(a)(1)(B) (regardless of whether the corporations are includible corporations under section 1504(b)). The separate affiliated group for a controlled corporation is determined in a similar manner (with the controlled corporation as the common parent).

Effective date.—The provision is effective for distributions after the date of enactment. Transition relief is provided for any distribution that is (1) made pursuant to an agreement which is binding on the date of enactment and at all times thereafter; (2) described in a ruling request submitted to the Internal Revenue Serv-

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[172] If immediately before the distribution, the distributing corporation had no assets other than stock or securities in the controlled corporations, then each of the controlled corporations must be engaged immediately after the distribution in the active conduct of a trade or business.

[173] Rev. Proc. 99–3, sec. 4.01(33), 1999–1 I.R.B. 111.

[174] Rev. Proc. 86–41, sec. 4.03(4), 1986–2 C.B. 716; Rev. Proc. 77–37, sec. 3.04, 1977–2 C.B. 568.

ice on or before such date; or (3) described on or before such date in a public announcement or in a filing with the Securities and Exchange Commission. A corporation can make an irrevocable election to have the transition relief not apply (so that the provision would apply to all distributions after the date of enactment).

Conference Agreement

The conference agreement follows the Senate amendment.

R. Modify the Definition of Rural Airport Eligible for Reduced Air Passenger Ticket Tax Rate (sec. 1111 of the Senate amendment and sec. 4261 of the Code)

Present Law

Air passenger transportation is subject to an excise tax equal to 8 percent of the amount paid plus $2 per flight segment. After September 30, 1999, the *ad valorem* portion of this tax will decrease to 7.5 percent and the flight segment portion will increase to $2.25. Additional increases in the flight segment tax are scheduled until that rate equals $3 per flight segment (with indexing of the $3 amount one year after it is reached).

Flight segments to or from qualified rural airports are eligible for a reduced air passenger tax of 7.5 percent, with no segment tax being imposed on those segments. A qualified rural airport is defined as an airport that enplaned fewer than 100,000 passengers in the second preceding calendar year and either (1) is not located within 75 miles of a larger airport that is not qualified for the reduced tax rate or (2) was receiving essential air service subsidy payments as of August 5, 1997.

House Bill

No provision.

Senate Amendment

The definition of qualified rural airport is expanded to include otherwise qualified airports that are located within 75 miles of an unqualified, larger airports if the smaller airports are not connected by road to the larger airports (e.g., an airport on an island not connected by bridge to the mainland).

Effective date.—The provision is effective for amounts paid after December 31, 1999, for air transportation beginning after that date.

Conference Agreement

The conference agreement follows the Senate amendment.

S. Dividends Paid by Cooperatives (sec. 1112 of the Senate amendment and sec. 1388(a) of the Code)

Present Law

Cooperatives, including tax-exempt farmers' cooperatives, are treated like a conduit for Federal income tax purposes since a coop-

erative may deduct patronage dividends paid from its taxable income. In general, patronage dividends are amounts paid to patrons (1) on the basis of the quantity or value of business done with or for its patrons, (2) under a valid enforceable written obligation to the patron to pay such amount, which obligation existed before the cooperative received such amounts, and (3) which is determined by reference to the net earnings of the cooperative from business done with or for its patrons.

Treasury Regulations provide that net earnings are shall be reduced by dividends paid on capital stock or other proprietary capital interests. The effect of this rule is to reduce the amount of earnings that the cooperative can treat as patronage earnings which reduces the amount that cooperative can deduct as patronage dividends.

House Bill

No provision.

Senate Amendment

Under the amendment, patronage-sourced income is not reduced to the extent that the organizational documents (articles of incorporation, bylaws, or contract with patrons) provide that dividends on capital stock (or other proprietary capital interests) are "in addition" to amounts otherwise payable as patronage dividends.

Effective date.—The Senate amendment is effective for distributions made in taxable years beginning after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

T. Modify Personal Holding Company "Lending or Finance Business" Exception (sec. 1114 of the bill and sec. 542 of the Code)

Personal holding companies (PHC's) are subject to a 39.6% tax on undistributed PHC income. This tax can be avoided by distributing the income to shareholders, who then pay shareholder level tax. PHC's are closely held companies with at least 60% "personal holding company income" (PHCI). This is generally passive income, including interest, dividends, and rents. Certain rent is excluded from the definition, if rent is at least 50 percent of the adjusted ordinary gross income of the company and other undistributed PHCI does not exceed 10 percent of the adjusted ordinary gross income.

In the case of a group of corporations filing a consolidated return, with certain exceptions, the application of the PHC tax to the group and any member thereof is generally determined on the basis of consolidated income and consolidated PHCI. If any member of the group is excluded from the definition of a PHC under certain provisions (including one for certain lending or finance businesses), then each other member of the group is tested separately for PHC status.

A special rule of present law excludes a lending or finance business from the definition of a PHC if certain requirements are met. At least 60% of its income must come from the active conduct of a lending or finance business, and no more than 20% of its adjusted gross income may be from certain other PHCI. A lending or finance business does not include a business of making loans longer than 144 months (12 years). Also, the deductions attributable to this active lending or finance business (but not including interest expense) must be at least 5 percent of income over $500,000 (plus 15 percent of income under that amount).

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the personal holding company exclusion for lending or finance companies to provide that, in determining whether a member of an affiliated group (as defined in section 1504(a)(1)) filing a consolidated return is a lending or finance company, only corporations engaged in a lending or finance business are taken into account, and all such companies are aggregated for purposes of this determination. The effect of this rule is to treat a corporation as a lending or finance company if all companies engaged in a lending or finance business in the affiliated group, in the aggregate, satisfy the requirements of the exclusion.

The provision also repeals the business expense requirement and the limitation on the maturity of loans made by a lending or finance business.

The provision also broadens the definition of a lending or finance business to include providing financial or investment advisory services, as well as engaging in leasing, including entering into leases and/or purchasing, servicing, and/or disposing of leases and leased assets.

Rents that are not derived from the active and regular conduct of a lending or finance business would continue to be treated under the present law personal holding company income rules.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

U. Tax Credit for Modifications to Inter-City Buses Required Under the Americans with Disabilities Act of 1990 (sec. 1115 of the Senate amendment and sec. 44 of the Code)

Present Law

Present law provides a tax credit ("the disabled access credit") for eligible access expenditures paid or incurred by an eligible small business so that such business may comply with the Americans with Disabilities Act of 1990, (the "ADA"). The amount of the credit for any taxable year is equal to 50 percent of the eligible access expenditures for the taxable year that exceed $250 but do not

exceed $10,250. Therefore the maximum annual credit is $5,000. An eligible small business is defined for any taxable year as a person that had gross receipts for the preceding taxable year that did not exceed $1 million or had no more than 30 full-time employees during the preceding taxable year.

Eligible access expenditures are defined as amounts paid or incurred by an eligible small business for the purpose of enabling such eligible small business to comply with applicable requirements of the ADA, as in effect on the date of enactment of the credit. Eligible access expenditures generally include amounts paid or incurred (1) for the purpose of removing architectural, communication, physical, or transportation barriers which prevent a business from being accessible to, or usable by, individuals with disabilities; (2) to provide qualified interpreters or other effective methods of making aurally delivered materials available to individuals with hearing impairments; (3) to provide qualified readers, taped texts, hearing impairments; (3) to provide qualified readers, taped texts and other effective methods of making visually delivered materials available to individuals with visual impairments; (4) to acquire or modify equipment or devices for individuals with disabilities; or (5) to provide other similar services, modifications, materials, or equipment. The expenditures must be reasonable and necessary to accomplish these purposes.

The disabled access credit is a general business credit and is subject to the present-law limitations on the amount of the general business credit that may be used for any taxable year. However, the portion of the unused business credit for any taxable year that is attributable to the disabled access credit may not to be carried back to any taxable year ending before the date of enactment of the credit.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the disabled access credit to a business without regard to the eligible small business limitation generally applicable under the credit for the cost of making certain inter-city buses comply with the ADA under the Department of Transportation's ("DOT's") final rule making on September 28, 1998, (49 CFR Part 37). Specifically, the definition of eligible access expenditure under the credit is expanded to include the incremental capital cost paid or incurred by the taxpayer so that certain inter-city buses satisfy the DOT's rule making under the ADA. For purposes of this provision, the allowable credit is 50 percent of the eligible access expenditures, per bus, for the taxable year that exceed $250 but do not exceed $30,250. Therefore the maximum credit is $15,000, per bus. The otherwise allowable eligible access expenditures are reduced by any Federal or State grant monies received by the taxpayer to subsidize such expenditures relating to such intercity buses. For these purposes, inter-city buses are buses eligible for the reduced diesel fuel tax rate of 7.4 cents per gallon.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 1999 and before January 1, 2012.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

V. Provisions Relating to Deduction for Business Meals

1. Increase deduction for business meals (sec. 804 of the House bill and sec. 274(n) of the Code)

Present Law

Ordinary and necessary business expenses, as well as expenses incurred for the production of income, are generally deductible, subject to a number of restrictions and limitations. Generally, the amount allowable as a deduction for business meal and entertainment expenses is limited to 50 percent of the otherwise deductible amount. Exceptions to this 50 percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs, as well as to individuals subject to the hours of service limitations of the Department of Transportation.

House Bill

The provision phases in an increase from 50 percent to 80 percent in the deductible percentage of business meal (food and beverage) expenses.[175] The increase in the deductible percentage is phased in according to the following schedule:

Taxable years beginning in—	Deductible percentage
2005	55
2006	60
2007	65
2008	70
2009	75
2010 and thereafter	80

Effective date.—The provision is effective for taxable years beginning after 1999.

Senate Amendment

No provision.

Conference Agreement

The conference agreement increases the deductible percentage for business meal (food and beverage) expenses as follows:

Taxable years beginning in—	Deductible percentage
2006	55
2007 and thereafter	60

Effective date.—The provision is effective for taxable years beginning after 1999.

[175] The present-law 50 percent limitation continues to apply to entertainment expenses.

2. Increased deduction for business meals while operating under Department of Transportation hours of service limitations (sec. 1116 of the Senate amendment and sec. 274 of the Code)

Present Law

Ordinary and necessary business expenses, as well as expenses incurred for the production of income, are generally deductible, subject to a number of restrictions and limitations. Generally, the amount allowable as a deduction for food and beverage is limited to 50 percent of the otherwise deductible amount. Exceptions to the 50 percent rule are provided for food and beverages provided to crew members of certain vessels and offshore oil or gas platforms or drilling rigs.

The 1997 Act increased to 80 percent the deductible percentage of the cost of food and beverages consumed while away from home by an individual during, or incident to, a period of duty subject to the hours of service limitations of the Department of Transportation.

Individuals subject to the hours of service limitations of the Department of Transportation include:

(1) certain air transportation employees such as pilots, crew, dispatchers, mechanics, and control tower operators pursuant to Federal Aviation Administration regulations,

(2) interstate truck operators and interstate bus drivers pursuant to Department of Transportation regulations,

(3) certain railroad employees such as engineers, conductors, train crews, dispatchers and control operations personnel pursuant to Federal Railroad Administration regulations, and

(4) certain merchant mariners pursuant to Coast Guard regulations.

The increase in the deductible percentage is phased in according to the following schedule.

Taxable years beginning in—	Deductible percentage
1998, 1999	55
2000, 2001	60
2002, 2003	65
2004, 2005	70
2006, 2007	75
2008 and thereafter	80

House Bill

No provision.

Senate Amendment

The bill accelerates to taxable years beginning after 2006 the full 80 percent deduction for business meals while operating under Department of Transportation hours of service limitations.

Effective date.—The provision is effective for taxable years beginning after 2006.

Conference Agreement

The conference agreement follows the Senate amendment.

W. Authorize Limited Private Activity Tax-Exempt Financing for Highway Construction (sec. 1117 of the Senate amendment)

Present Law

Present law exempts interest on State or local government bonds from the regular income tax if the proceeds of the bonds are used to finance governmental activities of those units and the bonds are repaid with governmental revenues. Interest on bonds issued by States or local governments acting as conduits to provide financing for private persons is taxable unless a specific exception is provided in the Code. No such exception is provided for bonds issued to provide conduit financing for privately constructed and/or privately operated highways (e.g. toll roads).

House Bill

No provision.

Senate Amendment

The Senate amendment authorizes issuance of up to $15 billion of private activity tax-exempt bonds to finance the construction of up the 15 private highway pilot projects. Bonds for these projects generally will be subject to all Code provisions governing issuance of tax-exempt private activity bonds except (1) the annual State private activity bond volume limits and (2) no proceeds of these bonds may be used to finance land.

Effective date.—The provision applies to bonds issued after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment with a modification deleting the statutorily required report to Congress on the pilot program. The conferees intend that the Secretary of the Treasury and the Secretary of Transportation will prepare and submit to the Congress a report evaluating the overall effects of the program, including a description of each project receiving tax-exempt financing, the extent to which new technologies or construction techniques are used in the projects, information regarding any cost savings to the projects from the use of the new technologies or construction techniques, and the use and efficiency of the Federal subsidy provided by the tax-exempt financing.

X. Provisions Relating to Tax Incentives for the District of Columbia

1. Extend Tax Credit for First-time D.C. Homebuyers (sec. 1118 of the Senate amendment and sec. 1400C of the Code)

Present Law

First-time homebuyers of a principal residence in the District of Columbia are eligible for a nonrefundable tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum

credit applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The credit phases out for individual taxpayers with adjusted gross income between $70,000 and $90,000 ($110,000-$130,000 for joint filers). For purposes of eligibility, "first-time homebuyer" means any individual if such individual did not have a present ownership interest in a principal residence in the District of Columbia in the one year period ending on the date of the purchase of the residence to which the credit applies. The credit is scheduled to expire for residences purchased after December 31, 2000.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the D.C. first-time homebuyer tax credit for 1 year, through December 31, 2001. In addition, the Senate amendment increases the phase-out range for married individuals filing a joint return so that it is twice that of unmarried individuals (i.e., the credit phases out for joint filers with adjusted gross income between $140,000 and $180,000).

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement includes the provision in the Senate amendment increasing the phase-out range for married individuals filing a joint return so that it is twice that of unmarried individuals (i.e., the credit phases out for joint filers with adjusted gross income between $140,000 and $180,000). The increase in the phase-out range is effective with respect to property purchased on or after the date of enactment.

The conference agreement does not include the Senate amendment provision extending the homebuyer credit.

2. Expand the Zero-Percent Capital Gains Rate for DC Zone Assets (sec. 1119 of the Senate amendment and sec. 1400B of the Code)

Present Law

Present law provides a zero-percent capital gains rate for capital gains from the sale of certain qualified DC Zone assets held for more than five years. In general, a "DC Zone asset" means stock or partnership interests held in, or tangible assets held by, a DC Zone business. A DC Zone business generally refers to certain enterprise zone businesses within the DC Zone.[176] For purposes of the zero-percent capital gains rate, the D.C. Zone is defined to in-

[71] For purposes of the zero-percent capital gains rate, a DC Zone business is defined by reference to the definition of an enterprise zone business in section 1397B, except that (1) the requirement that 35 percent of the employees of the business must be residents of the DC Zone does not apply, and (2) the DC Zone business must derive at least 80 percent (as opposed to 50 percent) of its total gross income from the active conduct of a qualified business within the DC Zone (sec. 1400B(c)).

clude all census tracts within the District of Columbia where the poverty rate is not less than 10 percent as determined on the basis of the 1990 Census (sec. 1400B(d)).

House Bill

No provision.

Senate Amendment

The Senate amendment eliminates the 10-percent poverty rate limitation for purposes of the zero-percent capital gains rate. Thus, the zero-percent capital gains rate applies to capital gains from the sale of assets held more than five years attributable to certain qualifying businesses located in the District of Columbia.

Effective date.—The provision is effective for DC Zone business stock and partnership interests originally issued after, and DC Zone business property assets originally acquired by the taxpayer after, December 31, 1999.

Conference Agreement

The conference agreement does not include the Senate amendment.

Y. Establish a Seven-Year Recovery Period for Natural Gas Gathering Lines (sec. 1120 of the Senate amendment and sec. 168 of the Code)

Present Law

The applicable recovery period for assets placed in service under the Modified Accelerated Cost Recovery System is based on the "class life of the property." The class lives of assets placed in service after 1986 are set forth in Revenue Procedure 87–56.[177] Revenue Procedure 87–56 includes two asset classes that could describe natural gas gathering lines owned by nonproducers of natural gas. Asset class 13.2, describing assets used in the exploration for and production of petroleum and natural gas deposits, provides a class life of 14 years and a depreciation recovery period of seven years. Asset class 46.0, describing pipeline transportation, provides a class life of 22 years and a recovery period of 15 years. The uncertainty regarding the appropriate recovery period has resulted in litigation between taxpayers and the IRS. Recently, the 10th Circuit Court of Appeals held that natural gas gathering lines owned by nonproducers fall within the scope of Asset class 13.2 (*i.e.,* 7-year recovery period).[178]

House Bill

No provision.

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[177] 1987–2 C.B. 674.

[178] *Duke Energy v. Commissioner,* 172 F. 3d 1255 (10th Cir. 1999), *Rev'g* 109 T.C. 416 (1997). *See also True v. United States,* 97–2 U.S. Tax Cas. (CCH) par. 50,946 (D. Wyo. 1997).

Senate Amendment

The Senate amendment establishes a statutory 7-year recovery period for all natural gas gathering lines. A natural gas gathering line is defined to include pipe, equipment, and appurtenances that is (1) determined to be a gathering line by the Federal Energy Regulatory Commission, or (2) used to deliver natural gas from the wellhead or a common point to the point at which such gas first reaches (a) a gas processing plant, (b) an interconnection with an interstate transmission line, (c) an interconnection with an intrastate transmission line, or (d) a direct interconnection with a local distribution company, a gas storage facility, or an industrial consumer.

Effective date.—The provision is effective for property placed in service on or after the date of enactment. No inference is intended as to the proper treatment of such property placed in service before the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

Z. Reclassify Air Transportation on Certain Small Seaplanes as Non-Commercial Aviation for Excise Tax Purposes (sec. 1121 of the Senate amendment and sec. 4261 of the Code)

Present Law

Commercial air passenger transportation is subject to an excise tax equal to 8 percent of the amount paid plus $2 per flight segment. After September 30, 1999, the *ad valorem* portion of this tax will decrease to 7.5 percent and the flight segment portion will increase to $2.25. Additional increases in the flight segment tax are scheduled until that rate equals $3 per flight segment (with indexing of the $3 amount one year after it is reached). In addition, fuel used in commercial aviation is subject to a 4.3-cents-per-gallon excise tax on fuels used in the aircraft.

In lieu of the ticket taxes imposed on commercial air passenger transportation, non-commercial transportation is subject to excise taxes on the fuels used in the aircraft. Non-commercial air transportation is defined as transportation which is not for hire. The fuels excise tax rates are 19.3 cents per gallon (aviation gasoline) and 21.8 cents per gallon (jet fuel).

Revenues from all of these excise taxes are deposited in the Airport and Airway Trust Fund to finance Federal Aviation Administration programs.

House Bill

No provision.

Senate Amendment

The Senate amendment re-classifies passenger transportation for hire on certain small seaplanes as non-commercial aviation. As such, the transportation will be subject to the full 19.3 cents-per-

gallon and 21.8-cents-per-gallon Airport and Airway Trust Fund excise taxes rather than the passenger ticket tax. Transportation is eligible for this provision only if it occurs on seaplanes (planes that both take off from and land on water) and that have a maximum certificated takeoff weight of 6,000 pounds or less with respect to any flight segment.

Effective date.—The provision is effective for transportation beginning after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

XIV. ADDITIONAL MISCELLANEOUS PROVISIONS

A. Exemption From Federal Income Tax for Amounts Received by Holocaust Victims' and Their Heirs (sec. 1122 of the Senate Amendment)

Present Law

Under the Code, gross income means "income from whatever source derived" except for certain items specifically exempt or excluded by statute (sec. 61). There is no explicit statutory exception from gross income provided for amounts received by Holocaust victims or their heirs.

House Bill

No provision.

Senate Amendment

The Senate amendment provides an exclusion from gross income for any amount received by an individual or any heir of the individual: (1) from the Swiss Humanitarian Fund established by the government of Switzerland or from any similar fund established in any foreign country; (2) as a result of the settlement of the action entitled, "In re Holocaust Victims' Asset Litigation", (E.D. NY), C.A. No. 96–4849, or as a result of any similar action; and (3) the value of land (including structures thereon) recovered by an individual (or any heir of the individual) from a government of a foreign country as a result of a settlement of a claim arising out of the confiscation of such land in connection with the Holocaust.

Effective date.—The provision is effective with regard to any amounts received before, on, or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment provision but only on a prospective basis.

Effective date.—The provision is effective with regard to any amounts received on or after the date of enactment. No inference is intended as to the proper treatment of payments made before the date of enactment.

B. Medical Innovation Tax Credit (section 1137 of the Senate amendment and new section 41A of the Code)

Present Law

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 exceeds its base amount for that year. In the case of contract research expenditures, generally only 65 percent of such expenditures are included in the calculation of a taxpayer's total qualified research expenditures. The research tax credit expired and generally does not apply to amounts paid or incurred after June 30, 1998.

House Bill

No provision.

Senate Amendment

The Senate amendment permits a taxpayer to claim a 40-percent credit for qualified medical research expenditures made with respect to certain human clinical testing of any drug, biologic, or medical device. The credit would apply to qualified medical research expenditures in excess of a base period amount. Qualified medical research expenditures are only those amounts paid to certain academic institutions.

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

Conference Agreement

The conference agreement follows the Senate amendment.

C. Capital Gain Holding Period for Horses (sec. 812 of the Senate amendment and sec. 1231 of the Code)

Present Law

Under present law, cattle and horses held by the taxpayer for draft, breeding, dairy, or sporting purposes and held 24 months or more are eligible for capital gain treatment. Other livestock held for these purposes are eligible for capital gain treatment if held for 12 months or more.

House Bill

No provision.

Senate Amendment

The Senate amendment reduces the 24-month capital gain holding period for horses to 12 months.

Effective date.—The provision is effective for dispositions after December 31, 2000.

Conference Agreement

The conference agreement does not include the provision in the Senate amendment.

D. Disclosure of Tax Return Information for Combined Employment Tax Reporting (sec. 1131 of the Senate amendment and sec. 6103(d) of the Code)

Present Law

Traditionally, Federal tax forms are filed with the Federal government and State tax forms are filed with individual States. This necessitates duplication of items common to both returns. Some States have recently been working with the IRS to implement combined State and Federal reporting of certain types of items on one form as a way of reducing the burdens on taxpayers.

The State of Montana and the IRS have cooperatively developed a system to combine State and Federal employment tax reporting on one form. The one form contains exclusively Federal data, exclusively State data, and information common to both: the taxpayer's name, address, TIN, and signature.

The Code permits implementation of a demonstration project to assess the feasibility and desirability of expanding combined reporting in the future. There are several limitations on the demonstration project. First, it is limited to the State of Montana and the IRS. Second, it is limited to employment tax reporting. Third, it is limited to disclosure of the name, address, TIN, and signature of the taxpayer, which is information common to both the Montana and Federal portions of the combined form. Fourth, it is limited to a period of five years. The provision will expire on August 5, 2002.

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

House Bill

No provision.

Senate Amendment

The Senate amendment permits the Secretary to disclose taxpayer identity information and signatures to any State for purposes of carrying out a combined Federal and State employment tax reporting program.

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

E. Tax Rates for Trusts with Disabled Beneficiary (sec. 211 of the Senate amendment and section 1 of the Code)

Present Law

Taxation of trusts

Trusts are treated as conduits where income distributed to beneficiaries is taxed to the beneficiaries and not the trust. Income which the trust accumulates and does not distribute to beneficiaries in the year earned is taxed to the trust.

Income tax rate structure

To determine regular income tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. The income bracket amounts are indexed for inflation. Separate rate schedules apply based on an individual's filing status, including estates and trusts. For 1999, the individual regular income tax rate schedules are shown below.

Table 1.—Federal Individual Income Tax Rates for 1999

If taxable income is:	Then income tax equals:
Single individuals	
$0–25,750	15 percent of taxable income
$25,750–$62,450	$3,862.50, plus 28% of the amount over $25,750
$62,450–$130,250	$14,138.50 plus 31% of the amount over $62,450
$130,250–$283,150	$35,156.50 plus 36% of the amount over $130,250
Over $283,150	$90,200.50 plus 39.6% of the amount over $283,150
Estates and trusts	
$0–$1,750	15 percent of taxable income
$1,750–$4,050	$262.50 plus 28% of the excess over $1,750
$4,050–$6,200	$906.50 plus 31% of the amount over $4,050
$6,200–$8,450	$1,573 plus 36% of the amount over $6,200
Over $8,450	$2,383 plus 39.6% of the amount over $8,450
Over $283,150	$87,548 plus 39.6% of the amount over $283,150

House Bill

No provision.

Senate Amendment

The Senate amendment provides that the tax rates applicable to a single individual will also apply to a trust whose exclusive purpose is to provide reasonable amounts for the support and maintenance of its sole beneficiary who is totally and permanently disabled (within the meaning of sec. 22(e)(3)) for the trust's entire taxable year.

Effective date.—The Senate amendment provision is effective for taxable years beginning after December 31, 2006.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

F. Taxation of Flights on Noncommercial Aircraft (sec. 370 of the Senate amendment and sec. 132 of the Code)

Present Law

In general under present law, the value of personal use of an employer-provided aircraft is includible in the gross income and wages of the employee. Under one exception to this rule, if 50 percent or more of the regular seating capacity of an aircraft is occupied by individuals whose flights are primarily for the employer's business, the value of a flight on that aircraft by any employee who is not flying primarily for the employer's business is deemed to be zero.[179] Thus, no amount is includible in the income of the employee by reason of such a flight.

Present law also provides an exclusion from gross income and wages for no-additional-cost-services. In general, a no-additional-cost-service is any service provided by an employer to an employee if such service if offered for sale to customers in the ordinary course of the line of business of the employer in which the employee is performing services, and the employer incurs no substantial additional cost (including forgone revenue) in providing such service to the employee (determined without regard to any amount paid for the employee for such service). Under this rule, services provided to the spouse or dependent child of the employee are treated as if provided to the employee. In addition, the term "employee" includes former employees who separated from service from the employer by reason of retirement or disability and surviving spouses of employees. The exclusion does not apply with respect to a no-additional-cost service provided to a highly compensated employee unless the service is available on a nondiscriminatory basis.

Except as described above, these exclusions are generally not available with respect to individuals who are not employees, e.g., independent contractors.

House Bill

No provision.

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[179] Treas. reg. sec. 1.61–21(g)(12).

Senate Amendment

Under the provision, the value of certain transportation provided to an employee on a noncommercially operated aircraft is treated as a no-additional-cost-service. The provision applies to transportation provided to an employee by an employer on a noncommercially operated aircraft if (1) the transportation is provided on a flight made in the ordinary course of the trade or business of the employer owning or leasing such aircraft for use in such trade or business, (2) the flight would have been made even if the employee were not being transported, and (3) and no substantial additional cost is incurred in providing the transportation.

As under the present-law rule relating to no-additional-cost-services, services provided to the spouse or dependent child of the employee are treated as if provided to the employee. In addition, the term "employee" includes former employees who separated from service from the employer by reason of retirement or disability and surviving spouses of employees. Also, the exclusion does not apply with respect to a no-additional-cost service provided to a highly compensated employee unless the service is available on a nondiscriminatory basis.

In addition, under the provision, use of noncommercial aircraft by any individual is treated as use by an employee if no regularly scheduled commercial flight is available on the day of the flight from the air facility at the individual's location to the area surrounding the air facility where the noncommercial flight ends.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

G. Exclusion for Certain Severance Payments (sec. 1135 of the Senate amendment and new sec. 139 of the Code)

Present Law

Under present law, severance payments are includible in gross income.

House Bill

No provision.

Senate Amendment

Under the provision, up to $2,000 of qualified severance payments received with respect to a separation from employment are excludable from the gross income of the recipient. Qualified severance payments are payments received by an individual on account of separation from employment in connection with a reduction in the employer's work force. The exclusion is not available if the individual becomes employed within 6 months of the separation from employment at a compensation level that is at least 95 percent of the compensation the individual received before the separation.

The exclusion does not apply if the total severance payments received by the individual in connection with the separation from employment exceed $75,000.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000, and before January 1, 2002.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

H. FUTA Treatment of Maple Syrup Workers (sec. 1132 of the Senate amendment and sec. of the Code)

Present Law

In general

For purposes of the FUTA tax, a person is considered an employer, if the person pays wages of $1,500 or more in any calendar quarter in the calendar year or the immediately prior calendar year and employs at least one individual for one day (or portion thereof) on at least 20 days during the calender year or immediately prior calender year. For these purposes, each day must occur in a different calendar week. Generally, qualifying as an employer results in the obligation to pay FUTA taxes.

Agricultural labor

In the case of agricultural labor, a person is considered an employer, if the person pays wages of $20,000 or more of agricultural labor in any calendar quarter in the calendar year or the immediately prior calendar year and employs at least ten individuals for one day (or portion thereof) on at least 20 days during the calender year or immediately prior calender year. For these purposes, each day must occur in a different calendar week. Generally, qualifying as an employer results in the obligation to pay FUTA taxes.

The production or harvesting of maple syrup generally constitutes agricultural labor only if such services are performed on a farm.

House Bill

No provision.

Senate Amendment

The Senate amendment provides that, for purposes of FUTA tax, agricultural labor includes any labor connected to the harvesting or production of maple sap into maple syrup or sugar, regardless of the location of the labor.

Effective date.—The Senate amendment provision is effective on the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

I. Modify Rules Governing Tax-Exempt Bonds for Section 501(c)(3) Organizations as Applied to Organizations Engaged in Timber Conservation Activities (sec. 1133 of the Senate amendment and sec. 145 of the Code)

Present Law

Interest on State or local government bonds is tax-exempt when the proceeds of the bonds are used to finance activities carried out by or paid for by those governmental units. Interest on bonds issued by State or local governments acting as conduit borrowers for private businesses is taxable unless a specific exception is included in the Code. One such exemption allows tax-exempt bonds to be issued to finance activities of non-profit organizations described in Code section 501(c)(3) ("qualified 501(c)(3) bonds").

Qualified 501(c)(3) bonds may be issued only to finance exempt, as opposed to unrelated business, activities of these organizations. However, if the bonds are issued to finance property which is intended to be, or is in fact, sold to a private business while the bonds are outstanding, bond interest may be taxable. An example of such an issue would be qualified 501(c)(3) bonds issued to finance purchase of land and standing timber, when the timber was to be sold.

As is true of other private activities receiving tax-exempt financing, beneficiaries of qualified 501(c)(3) bonds are restricted in the arrangements they may have with private businesses relating to control and use of bond-financed property.

House Bill

No provision.

Senate Amendment

The Senate amendment modifies the rules governing issuance of qualified 501(c)(3) bonds to permit issuance of long-term bonds for the acquisition of timber land by organizations a principal purpose of which is conservation of that land as timber land. Under these rules, the bonds will not have to be repaid (to avoid loss of tax-exemption on interest) when the timber is harvested and sold. In addition, the Senate amendment provision allows these section 501(c)(3) organizations to enter into certain otherwise prohibited timber management arrangements with private businesses without losing tax-exemption on bonds used to finance the property and timber.

Effective date.—The provision is effective for bonds issued after the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

XV. EXTENSION OF EXPIRING TAX PROVISIONS

A. Extension of Research and Experimentation Tax Credit and Increase in the Rates for the Alternative Incremental Research Credit (sec. 1401 of the House bill, sec. 1201 of the Senate amendment, and sec. 41 of the Code)

Present Law

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.

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.

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.

House Bill

The House bill extends the research tax credit for five years—i.e., generally, for the period July 1, 1999, through June 30, 2004.

In addition, the House 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.

Effective date.—The extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1999, through June 30, 2004. The increase in the credit rate under the alternative incremental research credit is effective for taxable years beginning after June 30, 1999.

Senate Amendment

The Senate amendment extends the research tax credit permanently.

In addition, the Senate amendment increases the credit rate applicable under the alternative incremental research credit one percentage point per step, that is, identical to the House bill.

Effective date.—The extension of the research credit is effective for qualified research expenditures paid or incurred after June 30, 1999. The increase in the credit rate under the alternative incremental research credit is effective for taxable years beginning after June 30, 1999.

Conference Agreement

The conference agreement follows the House bill by extending the research credit through June 30, 2004.

In addition, the conference agreement follows the House bill and the Senate amendment by increasing the credit rate applicable under the alternative incremental research credit by one percentage point per step.

Effective date.—The extension of the research credit is effective for qualified research expenditures paid or incurred during the period July 1, 1999, through June 30, 2004. The increase in the credit rate under the alternative incremental research credit is effective for taxable years beginning after June 30, 1999.

B. Extend Exceptions under Subpart F for Active Financing Income (sec. 1402 of the House bill, sec. 1202 of the Senate amendment, and secs. 953 and 954 of the Code)

Present Law

Under the subpart F rules, 10-percent 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. In addition, 10-percent U.S. shareholders of a CFC 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, foreign base company services income, and insurance income apply for subpart F purposes for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business (so-called "active financing income"). These exceptions are applicable only for taxable years beginning in 1999.[180]

With respect to income derived in the active conduct of a banking, financing, or similar business, a CFC is required to be predominantly engaged in such business and to conduct substantial activity with respect to such business in order to qualify for the exceptions. In addition, certain nexus requirements apply, which provide that income derived by a CFC or a qualified business unit ("QBU") of a CFC 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. Moreover, the exceptions apply to income derived from certain cross border transactions, provided that certain requirements are met. Additional exceptions from foreign per-

[180] Temporary exceptions from the subpart F provisions for certain active financing income applied only for taxable years beginning in 1998. Those exceptions were extended and modified as part of the present-law provisions.

sonal holding company income apply for certain income derived by a securities dealer within the meaning of section 475 and for gain from the sale of active financing assets.

In the case of insurance, in addition to a temporary exception from foreign personal holding company income for certain income of a qualifying insurance company with respect to risks located within the CFC's country of creation or organization, certain temporary exceptions from insurance income and from foreign personal holding company income apply 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, additional temporary exceptions from insurance income and from foreign personal holding company income apply for certain income of certain CFCs or branches with respect to risks located in a country other than the United States, provided that the requirements for these exceptions are met.

House Bill

The House bill extends for five years the present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business.

Effective date.—The provision is effective for taxable years of a foreign corporation beginning after December 31, 1999, and before January 1, 2005, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporation end.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Extend Suspension of Net Income Limitation on Percentage Depletion from Marginal Oil and Gas Wells (sec. 1403 of the House bill, sec. 1203 of the Senate amendment, and sec. 613A of the Code)

Present Law

The Code permits taxpayers to recover their investments in oil and gas wells through depletion deductions. In the case of certain properties, the deductions may be determined using the percentage depletion method. Among the limitations that apply in calculating percentage depletion deductions is a restriction that, for oil and gas properties, the amount deducted may not exceed 100 percent of the net income from that property in any year (sec. 613(a)).

Special percentage depletion rules apply to oil and gas production from "marginal" properties (sec. 613A(c)(6)). Marginal produc-

tion is defined as domestic crude oil and natural gas production from stripper well property or from property substantially all of the production from which during the calendar year is heavy oil. Stripper well property is property from which the average daily production is 15 barrel equivalents or less, determined by dividing the average daily production of domestic crude oil and domestic natural gas from producing wells on the property for the calendar year by the number of wells. Heavy oil is domestic crude oil with a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Fahrenheit). Under one such special rule, the 100-percent-of-net-income limitation does not apply to domestic oil and gas production from marginal properties during taxable years beginning after December 31, 1997, and before January 1, 2000.

House Bill

The House bill extends the present-law suspension of the 100-percent-of-net-income limitation with respect to oil and gas production from marginal wells to include taxable years beginning after December 31, 1999, and before January 1, 2005.

Effective date.—The provision is effective for taxable years beginning after December 31, 1999.

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

D. Extend the Work Opportunity Tax Credit (sec. 1404 of the House bill, sec. 1204 of the Senate amendment, and sec. 51 of the Code)

Present Law

In general

The work opportunity tax credit ("WOTC"), which expired on June 30, 1999, 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. Generally, 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.

The maximum credit per employee is $2,400 (40% 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 than 120 hours in the first year of employment.

Expiration date

The credit is effective for wages paid or incurred to a qualified individual who began work for an employer before July 1, 1999.

House Bill

The House bill extends the work opportunity tax credit for 30 months (through December 31, 2001). The House bill also directs the Secretary of the Treasury to expedite procedures to allow taxpayers to satisfy their WOTC filing requirements (e.g., Form 8850) by electronic means.

Effective date.—The House bill provision is effective for wages paid or incurred to qualified individuals who begin work for the employer on or after July 1, 1999, and before January 1, 2002.

Senate Amendment

The Senate amendment extends the work opportunity tax credit for five years (through June 30, 2004).

Effective date.—The Senate amendment provision is effective for wages paid or incurred to qualified individuals who begin work for the employer on or after July 1, 1999, and before July 1, 2004.

Conference Agreement

The conference agreement provides for a 30-month extension of the work opportunity tax credit. The conferees also direct the Secretary of the Treasury to expedite the use of electronic filing of requests for certification under the credit. They believe that participation in the program by businesses should not be discouraged by the requirement that such forms (i.e., the Form 8850) be submitted in paper form.

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, 1999, and before January 1, 2002.

E. Extend the Welfare-To-Work Tax Credit (sec. 1404 of the House bill, sec. 1204 of the Senate amendment, and sec. 51A of the Code)

Present Law

The Code provides to employers a tax credit on the first $20,000 of eligible wages paid to qualified long-term family assist-

ance (AFDC or its successor program) recipients during the first two years of employment. The credit is 35 percent of the first $10,000 of eligible wages in the first year of employment and 50 percent of the first $10,000 of eligible wages in the second year of employment. The maximum credit is $8,500 per qualified employee.

Qualified long-term family assistance recipients are: (1) members of a family that has received family assistance for at least 18 consecutive months ending on the hiring date; (2) members of a family that has received family assistance for a total of at least 18 months (whether or not consecutive) after the date of enactment of this credit if they are hired within 2 years after the date that the 18–month total is reached; and (3) members of a family who are no longer eligible for family assistance because of either Federal or State time limits, if they are hired within 2 years after the Federal or State time limits made the family ineligible for family assistance.

Eligible wages include cash wages paid to an employee plus amounts paid by the employer for the following: (1) educational assistance excludable under a section 127 program (or that would be excludable but for the expiration of sec. 127); (2) health plan coverage for the employee, but not more than the applicable premium defined under section 4980B(f)(4); and (3) dependent care assistance excludable under section 129.

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 July 1, 1999.

House Bill

The House bill extends the welfare-to-work tax credit for 30 months.

Effective date.—The House bill provision extends the welfare-to-work credit effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1999, and before January 1, 2002.

Senate Amendment

The Senate amendment extends the welfare-to-work tax credit five years.

Effective date.—The Senate amendment provision extends the welfare-to-work credit effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1999, and before July 1, 2004.

Conference Agreement

The conference agreement provides for a 30–month extension of the welfare-to-work tax credit.

Effective date.—The provision is effective for wages paid or incurred to a qualified individual who begins work for an employer on or after July 1, 1999, and before January 1, 2002.

F. Extend and Modify Tax Credit for Electricity Produced by Wind and Closed-Loop Biomass Facilities (sec. 1205 of the Senate amendment and sec. 45 of the Code)

Present Law

An income tax credit is allowed for the production of electricity from either qualified wind energy or qualified "closed-loop" biomass facilities (sec. 45). The credit applies to electricity produced by a qualified wind energy facility placed in service after December 31, 1993, and before July 1, 1999, and to electricity produced by a qualified closed-loop biomass facility placed in service after December 31, 1992, and before July 1, 1999. The credit is allowable for production during the 10-year period after a facility is originally placed in service.

Closed-loop biomass is the use of plant matter, where the plants are grown for the sole purpose of being used to generate electricity. It does not include the use of waste materials (including, but not limited to, scrap wood, manure, and municipal or agricultural waste). The credit also is not available to taxpayers who use standing timber to produce electricity. In order to claim the credit, a taxpayer must own the facility and sell the electricity produced by the facility to an unrelated party.

House Bill

No provision.

Senate Amendment

The present-law tax credit for electricity produced by wind and closed-loop biomass is extended for five years, for facilities placed in service after June 30, 1999, and before July 1, 2004. The provision also modifies the tax credit to include electricity produced from poultry litter, for facilities placed in service after December 31, 1999, and before July 1, 2004. The credit for electricity produced from poultry litter is available to the lessor/operator of a qualified facility that is owned by a governmental entity. The credit further is expanded to include electricity produced from landfill gas by the owner of the gas collection facility, for electricity produced from facilities placed in service after December 31, 1999, and before June 30, 2004.

Finally, the credit is expanded to include electricity produced from certain other biomass (in addition to closed-loop biomass and poultry waste). This additional biomass is defined as solid, nonhazardous, cellulose waste material which is segregated from other waste materials and which is derived from forest resources, but not including old-growth timber. The term also includes urban sources such as waste pallets, crates, manufacturing and construction wood waste, and tree trimmings, or agricultural sources (including grain, orchard tree crops, vineyard legumes, sugar, and other crop by-products or residues. The term does not include unsegregated municipal solid waste or paper that commonly is recycled. In the case of this additional biomass, the credit applies to electricity produced after December 31, 1999 from facilities that are placed in service before January 1, 2003 (including facilities placed in service before

the date of enactment of this provision). The credit is allowed for production attributable to biomass produced at facilities that are co-fired with coal.

Effective date.—The extension of the tax credit for electricity produced from wind and closed-loop biomass is effective for facilities placed in service after June 30, 1999. The modification to include electricity produced from poultry waste and landfill gas is effective for facilities placed in service after December 31, 1999. The modification to include other types of biomass is effective for facilities placed in service before January 1, 2003, but no credits may be claimed for production before January 1, 2000.

Conference Agreement

The conference agreement follows the Senate amendment, with a modification limiting the extension to facilities producing electricity from wind, closed-loop biomass, and poultry waste (i.e., the conference agreement does not include landfill gas, closed-loop biomass, or other biomass as qualified sources of electricity). The provision applies to facilities placed in service after June 30, 1999 and before July 1, 2003 (wind and closed-loop biomass) and after December 31, 1999 and before July 1, 2003 (poultry waste).

G. Extend Exemption From Diesel Dyeing Requirement for Certain Areas in Alaska (sec. 1206 of the Senate amendment and sec. 4082 of the Code)

Present Law

An excise tax totaling 24.4 cents per gallon is imposed on diesel fuel. The diesel fuel tax is imposed on removal of the fuel from a pipeline or barge terminal facility (i.e., at the "terminal rack"). Present law provides that tax is imposed on all diesel fuel removed from terminal facilities unless the fuel is destined for a nontaxable use and is indelibly dyed pursuant to Treasury Department regulations.

In general, the diesel fuel tax does not apply to non-transportation uses of the fuel. Off-highway business uses are included within this non-transportation use exemption. This exemption includes use on a farm for farming purposes and as fuel powering off-highway equipment (e.g., oil drilling equipment). Use as heating oil also is exempt. (Most fuel commonly referred to as heating oil is diesel fuel.) The tax also does not apply to fuel used by State and local governments, to exported fuels, and to fuels used in commercial shipping. Fuel used by intercity buses and trains is partially exempt from the diesel fuel tax.

A similar dyeing regime exists for diesel fuel under the Clean Air Act. That Act prohibits the use on highways of diesel fuel with a sulphur content exceeding prescribed levels. This "high sulphur" diesel fuel is required to be dyed by the EPA.

The State of Alaska generally is exempt from the Clean Air Act dyeing regime for a period established by the U.S. Environmental Protection Agency (urban areas) or permanently (remote areas). Diesel fuel used in Alaska is exempt from the excise tax dyeing requirements for periods when the EPA requirements do not apply.

House Bill

No provision.

Senate Amendment

The Senate amendment makes the excise tax exemption for Alaska urban areas permanent (i.e., independent of the EPA rules).

Effective date.—The provision is effective on the date of enactment.

Conference Agreement

The conference agreement does not include the Senate amendment provision.

H. Expensing of Environmental Remediation Expenditures and Expansion of Qualifying Sites (sec. 1207 of the Senate amendment and sec. 198 of the Code)

Present Law

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 (sec. 198). The deduction applies for both regular and alternative minimum tax purposes. The expenditure must be incurred in connection with the abatement or control of hazardous substances at a qualified contaminated site.

A "qualified contaminated site" generally is any property that (1) is held for use in a trade or business, for the production of income, or as inventory; (2) is certified by the appropriate State environmental agency to be located within a targeted area; and (3) contains (or potentially contains) a hazardous substance (so-called "brownfields"). Targeted areas are defined as: (1) empowerment zones and enterprise communities as designated under present law; (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. However, sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 cannot qualify as targeted areas.

Eligible expenditures are those paid or incurred before January 1, 2001.

House Bill

No provision.

Senate Amendment

The Senate amendment extends the expiration date for eligible expenditures to include those paid or incurred before July 1, 2004.

In addition, the bill eliminates the targeted area requirement, thereby expanding eligible sites to include any site containing (or potentially containing) a hazardous substance that is certified by

the appropriate State environmental agency, but not those sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

Effective date.—The provision to extend the expiration date is effective upon the date of enactment. The provision to expand the class of eligible sites is effective for expenditures paid or incurred after December 31, 1999.

Conference Agreement

The conference agreement follows the Senate amendment by expanding eligible sites to include any site containing (or potentially containing) a hazardous substance that is certified by the appropriate State environmental agency, but not those sites that are identified on the national priorities list under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

The conference agreement does not include an extension of the present-law expiration date for section 198.

Effective date.—The provision to expand the class of eligible sites is effective for expenditures paid or incurred after December 31, 1999.

XVI. REVENUE OFFSET PROVISIONS

A. Expand Reporting of Cancellation of Indebtedness Income (sec. 1501 of the House bill, sec. 1302 of the Senate amendment, and sec. 6050P of the Code)

Present Law

Under section 61(a)(12), a taxpayer's gross income includes income from the discharge of indebtedness. Section 6050P requires "applicable entities" to file information returns with the Internal Revenue Service (IRS) regarding any discharge of indebtedness of $600 or more.

The information return must set forth the name, address, and taxpayer identification number of the person whose debt was discharged, the amount of debt discharged, the date on which the debt was discharged, and any other information that the IRS requires to be provided. The information return must be filed in the manner and at the time specified by the IRS. The same information also must be provided to the person whose debt is discharged by January 31 of the year following the discharge.

"Applicable entities" include: (1) the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC), the National Credit Union Administration, and any successor or subunit of any of them; (2) any financial institution (as described in sec. 581 (relating to banks) or sec. 591(a) (relating to savings institutions)); (3) any credit union; (4) any corporation that is a direct or indirect subsidiary of an entity described in (2) or (3) which, by virtue of being affiliated with such entity, is subject to supervision and examination by a Federal or State agency regulating such entities; and (5) an executive, judicial, or legislative agency (as defined in 31 U.S.C. sec. 3701(a)(4)).

Failures to file correct information returns with the IRS or to furnish statements to taxpayers with respect to these discharges of indebtedness are subject to the same general penalty that is imposed with respect to failures to provide other types of information returns. Accordingly, the penalty for failure to furnish statements to taxpayers is generally $50 per failure, subject to a maximum of $100,000 for any calendar year. These penalties are not applicable if the failure is due to reasonable cause and not to willful neglect.

House Bill

The bill requires information reporting on indebtedness discharged by any organization a significant trade or business of which is the lending of money (such as finance companies and credit card companies whether or not affiliated with financial institutions).

Effective date.—The provision is effective with respect to discharges of indebtedness after December 31, 1999.

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

B. Extension of IRS User Fees (sec. 1502 of the House bill, sec. 1304 of the Senate amendment, and new sec. 7527 of the Code)

Present Law

The IRS provides written responses to questions of individuals, corporations, and organizations relating to their tax status or the effects of particular transactions for tax purposes. The IRS generally charges a fee for requests for a letter ruling, determination letter, opinion letter, or other similar ruling or determination. Public Law 104–117 [181] extended the statutory authorization for these user fees [182] through September 30, 2003.

House Bill

The bill extends the statutory authorization for these user fees through September 30, 2009. The bill also moves the statutory authorization for these fees into the Internal Revenue Code.

Effective date.—The provision, including moving the statutory authorization for these fees into the Code and repealing the off-Code statutory authorization for these fees, is effective for requests made after the date of enactment.

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[181] An Act to provide that members of the Armed Froces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996).

[182] These user fees were originally enacted in section 10511 of the Revenue Act of 1987 (Public Law 100–203, December 22, 1987).

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

C. Impose Limitation on Prefunding of Certain Employee Benefits (sec. 1503 of the House bill, sec. 1312 of the Senate amendment, and secs. 419A and 4976 of the Code)

Present Law

Under present law, contributions to a welfare benefit fund generally are deductible when paid, but only to the extent permitted under the rules of sections 419 and 419A. The amount of an employer's deduction in any year for contributions to a welfare benefit fund cannot exceed the fund's qualified cost for the year minus the fund's after-tax income for the year. With certain exceptions, the term qualified cost means the sum of (1) the amount that would be deductible for benefits provided during the year if the employer paid them directly and was on the cash method of accounting, and (2) within limits, the amount of any addition to a qualified asset account for the year. A qualified asset account includes any account consisting of assets set aside for the payment of disability benefits, medical benefits, supplemental unemployment compensation or severance pay benefits, or life insurance benefits. The account limit for a qualified asset account for a taxable year is generally the amount reasonably and actuarially necessary to fund claims incurred but unpaid (as of the close of the taxable year) for benefits with respect to which the account is maintained and the administrative costs incurred with respect to those claims. Specific additional reserves are allowed for future provision of post-retirement medical and life insurance benefits.

The deduction limits of sections 419 and 419A for contributions to welfare benefit funds do not apply in the case of certain 10-or-more employer plans. A plan is a 10-or-more employer plan if (1) more than one employer contributes to it, and (2) no employer is normally required to contribute more than 10 percent of the total contributions contributed under the plan by all employers. The exception is not available if the plan maintains experience-rating arrangements with respect to individual employers.

If any portion of a welfare benefit fund reverts to the benefit of an employer, an excise tax equal to 100 percent of the reversion is imposed on the employer.

House Bill

The present-law exception to the deduction limit for 10-or-more employer plans is limited to plans that provide only medical benefits, disability benefits, and qualifying group-term life insurance benefits to plan beneficiaries. The legislative history provides that qualifying group-term life insurance benefits do not include any arrangements that permit a plan beneficiary to directly or indirectly

access all or part of the account value of any life insurance contract, whether through a policy loan, a partial or complete surrender of the policy, or otherwise. Also, the legislative history provides that it is intended that qualifying group-term life insurance benefits do not include any arrangement whereby a plan beneficiary may receive a policy without a stated account value that has the potential to give rise to an account value whether through the exchange of such policy for another policy that would have an account value or otherwise. The 10-or-more employer plan exception is no longer available with respect to plans that provide supplemental unemployment compensation, severance pay, or life insurance (other than qualifying group-term life insurance) benefits. Thus, the generally applicable deduction limits (sections 419 and 419A) apply to plans providing these benefits.

In addition, if any portion of a welfare benefit fund attributable to contributions that are deductible pursuant to the 10-or-more employer exception (and earnings thereon) is used for a purpose other than for providing medical benefits, disability benefits, or qualifying group-term life insurance benefits to plan beneficiaries, such portion is treated as reverting to the benefit of the employers maintaining the fund and is subject to the imposition of the 100-percent excise tax. Thus, for example, cash payments to employees upon termination of the fund, and loans or other distributions to the employee or employer, would be treated as giving rise to a reversion that is subject to the excise tax.

The legislative history indicates that no inference is intended with respect to the validity of any 10-or-more employer arrangement under the provisions of present law.

Effective date.—The House bill is effective with respect to contributions paid or accrued on or after June 9, 1999, in taxable years ending after such date.

Senate Amendment

The Senate amendment is the same as the House bill, except the Senate amendment states that group-term life insurance benefits that qualify for the 10-or-more employer exception are group-term life insurance benefits that do not provide directly or indirectly for any cash surrender value or other money that can be paid, assigned, borrowed, or pledged for collateral for a loan. In addition, the legislative history indicates that it is intended that group-term life insurance benefits do not fail to be qualifying group-term life insurance benefits solely as a result of the inclusion of de minimis ancillary benefits, as described in Treasury regulations.

Effective date.—The effective date of the Senate amendment is the same as the effective date of the House bill.

Conference Agreement

The conference agreement follows the Senate amendment. It is intended that group-term life insurance benefits do not fail to be qualifying group-term life insurance benefits solely as a result of the inclusion of de minimis ancillary benefits, as described in Treasury regulations under the provision.

D. Increase Elective Withholding Rate for Nonperiodic Distributions from Deferred Compensation Plans (sec. 1504 of the bill and sec. 3405 of the Code)

Present Law

Present law provides that income tax withholding is required on designated distributions from employer compensation plans (whether or not such plans are tax qualified), individual retirement arrangements ("IRAs"), and commercial annuities unless the payee elects not to have withholding apply. A designated distribution does not include any payment (1) that is wages, (2) the portion of which it is reasonable to believe is not includible in gross income,[183] (3) that is subject to withholding of tax on nonresident aliens and foreign corporations (or would be subject to such withholding but for a tax treaty), or (4) that is a dividend paid on certain employer securities (as defined in sec. 404(k)(2)).

Tax is generally withheld on the taxable portion of any periodic payment as if the payment is wages to the payee. A periodic payment is a designated distribution that is an annuity or similar periodic payment.

In the case of a nonperiodic distribution, tax generally is withheld at a flat 10-percent rate unless the payee makes an election not to have withholding apply. A nonperiodic distribution is any distribution that is not a periodic distribution. Under current administrative rules, an individual receiving a nonperiodic distribution can designate an amount to be withheld in addition to the 10-percent otherwise required to be withheld.

Under present law, in the case of a nonperiodic distribution that is an eligible rollover distribution, tax is withheld at a 20-percent rate unless the payee elects to have the distribution rolled directly over to an eligible retirement plan (i.e., an IRA, a qualified plan (sec. 401(a)) that is a defined contribution plan permitting direct deposits of rollover contributions, or a qualified annuity plan (sec. 403(a)). In general, an eligible rollover distribution includes any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan or qualified annuity plan. An eligible rollover distribution does not include any distribution that is part of a series of substantially equal periodic payments made (1) for the life (or life expectancy) of the employee or for the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (2) over a specified period of 10 years or more. An eligible rollover distribution also does not include any distribution required under the minimum distribution rules of section 401(a)(9), hardship distributions from section 401(k) plans, or the portion of a distribution that is not includible in income. The payee of an eligible rollover distribution can only elect not to have withholding apply by making the direct rollover election.

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[183] All IRA distributions are treated as if includible in income for purposes of this rule. A technical correction contained in the bill modifies this rule in the case of Roth IRAs.

House Bill

Under the bill, the withholding rate for nonperiodic distributions would be increased from 10 percent to 15 percent. As under present law, unless the distribution is an eligible rollover distribution, the payee could elect not to have withholding apply. The bill does not modify the 20-percent withholding rate that applies to any distribution that is an eligible rollover distribution.

Effective date.—The provision is effective for distributions made after December 31, 1999.

Senate Amendment

The provision is the same as the House bill.

Effective date.—Distributions made after December 31, 2000.

Conference Agreement

The conference agreement follows the Senate amendment.

E. Modify Treatment of Closely-Held REITs (sec. 1505 of the House bill, sec. 1320 of the Senate amendment, and sec. 856 of the Code)

Present Law

In general, a real estate investment trust ("REIT") is an entity that receives most of its income from passive real estate related investments and that receives pass-through treatment for income that is distributed to shareholders. If an electing entity meets the qualifications for REIT status, the portion of its income that is distributed to the investors each year generally is taxed to the investors without being subjected to tax at the REIT level.

A REIT must satisfy a number of tests on a year-by-year basis that relate to the entity's: (1) organizational structure; (2) source of income; (3) nature of assets; and (4) distribution of income.

Under the organizational structure test, except for the first taxable year for which an entity elects to be a REIT, the beneficial ownership of the entity must be held by 100 or more persons. Generally, no more than 50 percent of the value of the REIT's stock can be owned by five or fewer individuals during the last half of the taxable year. Certain attribution rules apply in making this determination. No similar rule applies to corporate ownership of a REIT. Certain transactions have been structured to attempt to achieve special tax benefits for an entity that controls a REIT.

House Bill

The House bill provision imposes as an additional requirement for REIT qualification that, except for the first taxable year for which an entity elects to be a REIT, no one person can own stock of a REIT possessing 50 percent or more of the combined voting power of all classes of voting stock or 50 percent or more of the total value of shares of all classes of stock of the REIT. For purposes of determining a person's stock ownership, rules similar to attribution rules for REIT independent contractor qualification under present law apply (secs. 856(d)(5) and 856(h)(3)). The provi-

sion does not apply to ownership by a REIT of 50 percent or more of the stock (vote or value) of another REIT.

An exception applies for a limited period to certain "incubator REITs". An incubator REIT is a corporation that elects to be treated as an incubator REIT and that meets all the following other requirements. (1) it has only voting common stock outstanding, (2) not more than 50 percent of the corporation's real estate assets consist of mortgages, (3) from not later than the beginning of the last half of the second taxable year, at least 10 percent of the corporation's capital is provided by lenders or equity investors who are unrelated to the corporation's largest shareholder, (4) the directors of the corporation must adopt a resolution setting forth an intent to engage in a going public transaction, and (5) no predecessor entity (including any entity from which the electing incubator REIT acquired assets in a transaction in which gain or loss was not recognized in whole or in part) had elected incubator REIT status.

The new ownership requirement does not apply to an electing incubator REIT until the end of the REIT's third taxable year; and can be extended for an additional two taxable years if the REIT so elects. However, a REIT cannot elect the additional two year extension unless the REIT agrees that if it does not engage in a going public transaction by the end of the extended eligibility period, it shall pay Federal income taxes for the two years of the extended period as if it had not made an incubator REIT election and had ceased to qualify as a REIT for those two taxable years. In such case, the corporation shall file appropriate amended returns within 3 months of the close of the extended eligibility period. Interest would be payable, but no substantial underpayment penalties would apply except in cases where there is a finding that incubator REIT status was elected for a principal purpose other than as part of a reasonable plan to engage in a going public transaction. Notification of shareholders and any other person whose tax position would reasonably be expected to be affected is also required.

If an electing incubator REIT does not elect to extend its initial 2-year extended eligibility period and has not engaged in a going public transaction by the end of such period, it must satisfy the new control requirements as of the beginning of its fourth taxable year (i.e., immediately after the close of the last taxable year of the two-year initial extension period) or it will be required to notify its shareholders and other persons that may be affected by its tax status, and pay Federal income tax as a corporation that has ceased to qualify as a REIT at that time.

If the Secretary of the Treasury determines that an incubator REIT election was filed for a principal purpose other than as part of a reasonable plan to undertake a going public transaction, an excise tax of $20,000 is imposed on each of the corporation's directors for each taxable year for which the election was in effect.

A going public transaction is defined as either (1) a public offering of shares of stock of the incubator REIT, (2) a transaction, or series of transactions, that result in the incubator REIT stock being regularly traded on an established securities market (as defined in section 897) and being held by shareholders unrelated to persons who held such stock before it began to be so regularly traded, or (3) any transaction resulting in ownership of the REIT by

200 or more persons (excluding the largest single shareholder) who in the aggregate own at least 50 percent of the stock of the REIT. Attribution rules apply in determining ownership of stock.

Effective date.—The provision is effective for taxable years ending after July 12, 1999. Any entity that elects (or has elected) REIT status for a taxable year including July 12, 1999, and which is both a controlled entity and has significant business assets or activities on such date, will not be subject to the proposal. Under this rule, a controlled entity with significant business assets or activities on July 14, 1999, can be grandfathered even if it makes its first REIT election after that date with its return for the taxable year including that date.

For purposes of the transition rules, the significant business assets or activities in place on July 12, 1999, must be real estate assets and activities of a type that would be qualified real estate assets and would produce qualified real estate related income for a REIT.

Senate Amendment

The Senate amendment is the same as the House bill except that the Senate amendment contains an additional qualification for incubator REIT status, namely, that the corporation must annually increase the value of real estate assets by at least 10 percent,

For purposes of determining whether a corporation has met the requirement that it annually increase the value of its real estate assets by 10 percent, the following rules shall apply. First, values shall be based on cost and properly capitalizable expenditures with no adjustment for depreciation. Second, the test shall be applied by comparing the value of assets at the end of the first taxable year with those at the end of the second taxable year and by similar successive taxable year comparisons during the eligibility period. Third, if a corporation fails the 10 percent comparison test for one taxable year, it may remedy the failure by increasing the value of real estate assets by 25 percent in the following taxable year, provided it meets all the other eligibility period requirements in that following taxable year.

Effective date.—The effective date of the Senate amendment is the same as the House bill except that the Senate amendment substitutes the date July 14, 1999 for the date July 12, 1999.

Conference Agreement

The conference agreement follows the Senate amendment with a modification in the attribution rules so that once stock is deemed owned by a qualified entity (a REIT or a partnership of which a REIT is at least a 50 percent partner) it will not be reattributed under section 318(a)(3)(C).

Effective date.—The effective date is the same as that of the Senate amendment.

F. Limit Conversion of Character of Income from Constructive Ownership Transactions (sec. 1506 of the House bill, sec. 1314 of the Senate amendment, and new sec. 1260 of the Code)

Present Law

The maximum individual income tax rate on ordinary income and short-term capital gain is 39.6 percent, while the maximum individual income tax rate on long-term capital gain generally is 20 percent. Long-term capital gain means gain from the sale or exchange of a capital asset held more than one year. For this purpose, gain from the termination of a right with respect to property that would be a capital asset in the hands of the taxpayer is treated as capital gain.[184]

A pass-thru entity (such as a partnership) generally is not subject to Federal income tax. Rather, each owner includes its share of a pass-thru entity's income, gain, loss, deduction or credit in its taxable income. Generally, the character of the item is determined at the entity level and flows through to the owners. Thus, for example, the treatment of an item of income by a partnership as ordinary income, short-term capital gain, or long-term capital gain retains its character when reported by each of the partners.

Investors may enter into forward contracts, notional principal contracts, and other similar arrangements with respect to property that provides the investor with the same or similar economic benefits as owning the property directly but with potentially different tax consequences (as to the character and timing of any gain).

House Bill

The House bill limits the amount of long-term capital gain a taxpayer could recognize from certain derivative contracts ("constructive ownership transaction") with respect to certain financial assets. The amount of long-term capital gain is limited to the amount of such gain the taxpayer would have had if the taxpayer held the asset directly during the term of the derivative contract. Any gain in excess of this amount is treated as ordinary income. An interest charge is imposed on the amount of gain that is treated as ordinary income. The House bill does not alter the tax treatment of the long-term capital gain that is not treated as ordinary income.

A taxpayer is treated as having entered into a constructive ownership transaction if the taxpayer (1) holds a long position under a notional principal contract with respect to the financial asset, (2) enters into a forward contract to acquire the financial asset, (3) is the holder of a call option, and the grantor of a put option, with respect to a financial asset, and the options have substantially equal strike prices and substantially contemporaneous maturity dates, or (4) to the extent provided in regulations, enters into one or more transactions, or acquires one or more other positions, that have substantially the same effect as any of the transactions described. The House bill anticipates that Treasury regulations, when issued, will provide specific standards for determining

[184] Section 1234A, as amended by the Taxpayer Relief Act of 1997.

when other types of financial transactions, like those specified in the provision, have the effect of replicating the economic benefits of direct ownership of a financial asset (and will be treated as a constructive ownership transaction).

A "financial asset" is defined as (1) any equity interest in a pass-thru entity, and (2) to the extent provided in regulations, any debt instrument and any stock in a corporation that is not a pass-thru entity. A "pass-thru entity" refers to (1) a regulated investment company, (2) a real estate investment trust, (3) an S corporation, (4) a partnership, (5) a trust, (6) a common trust fund, (7) a passive foreign investment company, (8) a foreign personal holding company, and (9) a foreign investment company.

The amount of recharacterized gain is calculated as the excess of the amount of long-term gain the taxpayer would have had absent this provision over the "net underlying long-term capital gain" attributable to the financial asset. The net underlying long-term capital gain is the amount of net capital gain the taxpayer would have realized if it had acquired the financial asset for its fair market value on the date the constructive ownership transaction was opened and sold the financial asset on the date the transaction was closed (only taking into account gains and losses that would have resulted from the constructive ownership of the financial asset).[185] The long-term capital gains rate on the net underlying long-term capital gain is determined by reference to the individual capital gains rates in section 1(h).

An interest charge is imposed on the underpayment of tax for each year that the constructive ownership transaction was open. The interest charge is the amount of interest that would be imposed under section 6601 had the recharacterized gain been included in the taxpayer's gross income during the term of the constructive ownership transaction. The recharacterized gain is treated as having accrued such that the gain in each successive year is equal to the gain in the prior year increased by a constant growth rate[186] during the term of the constructive ownership transaction.

A taxpayer is treated as holding a long position under a notional principal contract with respect to a financial asset if the person (1) has the right to be paid (or receive credit for) all or substantially all of the investment yield (including appreciation) on the financial asset for a specified period, and (2) is obligated to reimburse (or provide credit) for all or substantially all of any decline in the value of the financial asset. A forward contract is a contract to acquire in the future (or provide or receive credit for the future value of) any financial asset.

If the constructive ownership transaction is closed by reason of taking delivery of the underlying financial asset, the taxpayer is treated as having sold the contracts, options, or other positions that are part of the transaction for its fair market value on the closing date. However, the amount of gain that is recognized as a result of having taken delivery is limited to the amount of gain that is treated as ordinary income by reason of this provision (with appropriate basis adjustments for such gain).

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[185] A taxpayer must establish the amount of the net underlying long-term capital gain with clear and convincing evidence; otherwise, the amount is deemed to be zero.

[186] The accrual rate is the applicable Federal rate on the day the transaction closed.

The provision does not apply to any constructive ownership transaction if all of the positions that are part of the transaction are marked to market under the Code or regulations. The provision also does not apply to transactions entered into by tax-exempt organizations and foreign taxpayers.

The Treasury Department is authorized to prescribe regulations as necessary to carry out the purposes of the provision, including to (1) permit taxpayers to mark to market constructive ownership transactions in lieu of the provision, and (2) exclude certain forward contracts that do not convey substantially all of the economic return with respect to a financial asset.

Effective date.—The provision applies to transactions entered into on or after July 12, 1999.

Senate Amendment

The Senate amendment is the same as the House bill with some modifications. The Senate amendment modifies the definition of a "pass-thru entity" to include (1) a real estate mortgage investment conduit and (2) a passive foreign investment company that is also a controlled foreign corporation. The Committee report clarifies (1) the types of financial transactions that, under Treasury regulations, are expected to have substantially the same effect as those specified in the provision, and (2) the determination of the amount of any net underlying long-term capital gain. The Committee report further provides that no inference is intended as to the proper treatment of a constructive ownership transaction entered into prior to the effective date of the provision.

Effective date.—The provision applies to transactions entered into on or after July 12, 1999. It is intended that a contract, option or any other arrangement that is entered into or exercised on or after July 12, 1999 which extends or otherwise modifies the terms of a transaction entered into prior to such date is treated as a transaction entered into on or after July 12, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

G. Treatment of Excess Pension Assets Used for Retiree Health Benefits (sec. 1507 of the House bill, sec. 1305 of the Senate amendment, sec. 420 of the Code, and secs. 101, 403, and 408 of ERISA)

Present Law

Defined benefit pension plan assets generally may not revert to an employer prior to the termination of the plan and the satisfaction of all plan liabilities. A reversion prior to plan termination may constitute a prohibited transaction and may result in disqualification of the plan. Certain limitations and procedural requirements apply to a reversion upon plan termination. Any assets that revert to the employer upon plan termination are includible in the gross income of the employer and subject to an excise tax. The excise tax rate, which may be as high as 50 percent of the reversion, varies depending upon whether or not the employer maintains a replacement plan or makes certain benefit increases. Upon plan ter-

mination, the accrued benefits of all plan participants are required to be 100-percent vested.

A pension plan may provide medical benefits to retired employees through a section 401(h) account that is a part of such plan. A qualified transfer of excess assets of a defined benefit pension plan (other than a multiemployer plan) into a section 401(h) account that is a part of such plan does not result in plan disqualification and is not treated as a reversion to the employer or a prohibited transaction. Therefore, the transferred assets are not includible in the gross income of the employer and are not subject to the excise tax on reversions.

Qualified transfers are subject to amount and frequency limitations, use requirements, deduction limitations, vesting requirements and minimum benefit requirements. Excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. No more than one qualified transfer with respect to any plan may occur in any taxable year.

The transferred assets (and any income thereon) must be used to pay qualified current retiree health liabilities (either directly or through reimbursement) for the taxable year of the transfer. Transferred amounts generally must benefit all pension plan participants, other than key employees, who are entitled upon retirement to receive retiree medical benefits through the section 401(h) account. Retiree health benefits of key employees may not be paid (directly or indirectly) out of transferred assets. Amounts not used to pay qualified current retiree health liabilities for the taxable year of the transfer are to be returned at the end of the taxable year to the general assets of the plan. These amounts are not includible in the gross income of the employer, but are treated as an employer reversion and are subject to a 20-percent excise tax.

No deduction is allowed for (1) a qualified transfer of excess pension assets into a section 401(h) account, (2) the payment of qualified current retiree health liabilities out of transferred assets (and any income thereon) or (3) a return of amounts not used to pay qualified current retiree health liabilities to the general assets of the pension plan.

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer.

The minimum benefit requirement requires each group health plan under which applicable heath benefits are provided to provide substantially the same level of applicable health benefits for the taxable year of the transfer and the following 4 taxable years. The level of benefits that must be maintained is based on benefits provided in the year immediately preceding the taxable year of the transfer. Applicable health benefits are health benefits or coverage that are provided to (1) retirees who, immediately before the transfer, are entitled to receive such benefits upon retirement and who are entitled to pension benefits under the plan and (2) the spouses and dependents of such retirees.

The provision permitting a qualified transfer of excess pension assets to pay qualified current retiree health liabilities expires for taxable years beginning after December 31, 2000.[187]

House Bill

The present-law provision permitting qualified transfers of excess defined benefit pension plan assets to provide retiree health benefits under a section 401(h) account is extended through September 30, 2009. In addition, the present-law minimum benefit requirement is replaced by the minimum cost requirement that applied to qualified transfers before December 9, 1994, to section 401(h) accounts. Therefore, each group health plan or arrangement under which applicable health benefits are provided is required to provide a minimum dollar level of retiree health expenditures for the taxable year of the transfer and the following 4 taxable years. The minimum dollar level is the higher of the applicable employer costs for each of the 2 taxable years immediately preceding the taxable year of the transfer. The applicable employer cost for a taxable year is determined by dividing the employer's qualified current retiree health liabilities by the number of individuals to whom coverage for applicable health benefits was provided during the taxable year.

Effective date.—The House bill is effective with respect to qualified transfers of excess defined benefit pension plan assets to section 401(h) accounts after December 31, 2000, and before October 1, 2009. The modification of the minimum benefit requirement is effective with respect to transfers after the date of enactment.

Senate Amendment

The Senate amendment is the same as the House bill.[188]

Effective date.—Same as the House bill, except that the modification of the minimum benefit requirement is effective with respect to transfers after the date of enactment. In addition, the Senate amendment contains a transition rule regarding the minimum cost requirement. Under this rule, an employer must satisfy the minimum benefit requirement with respect to a qualified transfer that occurs after the date of enactment during the portion of the cost maintenance period of such transfer that overlaps the benefit maintenance period of a qualified transfer that occurs on or before the date of enactment. For example, suppose an employer (with a calendar year taxable year) made a qualified transfer in 1998. The minimum benefit requirement must be satisfied for calendar years 1998, 1999, 2000, 2001, and 2002. Suppose the employer also makes a qualified transfer in 2000. Then, the employer is required to satisfy the minimum benefit requirement in 2000, 2001, and

[187] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), provides that plan participants, the Secretaries of Treasury and the Department of Labor, the plan administrator, and each employee organization representing plan participants must be notified 60 days before a qualified transfer of excess assets to a retiree health benefits account occurs (ERISA sec. 103(e)). ERISA also provides that a qualified transfer is not a prohibited transaction under ERISA (ERISA sec. 408(b)(13)) or a prohibited reversion of assets to the employer (ERISA sec. 403(c)(1)). For purposes of these provisions, a qualified transfer is generally defined as a transfer pursuant to section 420 of the Internal Revenue Code, as in effect on January 1, 1995.

[188] The Senate amendment modifies the corresponding provisions of ERISA.

2002, and is required to satisfy the minimum cost requirement in 2003 and 2004.

Conference Agreement

The conference agreement follows the Senate amendment.

H. Modify Installment Method and Prohibit its Use by Accrual Method Taxpayers (sec. 1508 of the House bill, sec. 1313 of the Senate amendment, and secs. 453 and 453A of the Code)

Present Law

An accrual method taxpayer is generally required to recognize income when all the events have occurred that fix the right to the receipt of the income and the amount of the income can be determined with reasonable accuracy. The installment method of accounting provides an exception to this general principle of income recognition by allowing a taxpayer to defer the recognition of income from the disposition of certain property until payment is received. Sales to customers in the ordinary course of business are not eligible for the installment method, except for sales of property that is used or produced in the trade or business of farming and sales of timeshares and residential lots if an election to pay interest under section 453(l)(2)(B) is made.

A pledge rule provides that if an installment obligation is pledged as security for any indebtedness, the net proceeds[189] of such indebtedness are treated as a payment on the obligation, triggering the recognition of income. Actual payments received on the installment obligation subsequent to the receipt of the loan proceeds are not taken into account until such subsequent payments exceed the loan proceeds that were treated as payments. The pledge rule does not apply to sales of property used or produced in the trade or business of farming, to sales of timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), or to dispositions where the sales price does not exceed $150,000.

An additional rule requires the payment of interest on the deferred tax that is attributable to most large installment sales.

House Bill

Prohibition on the use of the installment method for accrual method dispositions

The provision generally prohibits the use of the installment method of accounting for dispositions of property that would otherwise be reported for Federal income tax purposes using an accrual method of accounting. The provision does not change present law regarding the availability of the installment method for dispositions of property used or produced in the trade or business of farming. The provision also does not change present law regarding the availability of the installment method for dispositions of timeshares

[189] The net proceeds equal the gross loan proceeds less the direct expenses of obtaining the loan.

or residential lots if the taxpayer elects to pay interest under section 453(l).

The provision does not change the ability of a cash method taxpayer to use the installment method. For example, a cash method individual owns all of the stock of a closely held accrual method corporation. This individual sells his stock for cash, a ten year note, and a percentage of the gross revenues of the company for next ten years. The provision would not change the ability of this individual to use the installment method in reporting the gain on the sale of the stock.

Modifications to the pledge rule

The provision modifies the pledge rule to provide that entering into any arrangement that gives the taxpayer the right to satisfy an obligation with an installment note will be treated in the same manner as the direct pledge of the installment note. For example, a taxpayer disposes of property for an installment note. The disposition is properly reported using the installment method. The taxpayer only recognizes gain as it receives the deferred payment. However, were the taxpayer to pledge the installment note as security for a loan, it would be required to treat the proceeds of such loan as a payment on the installment note, and recognize the appropriate amount of gain. Under the provision, the taxpayer would also be required to treat the proceeds of a loan as payment on the installment note to the extent the taxpayer had the right to "put" or repay the loan by transferring the installment note to the taxpayer's creditor. Other arrangements that have a similar effect would be treated in the same manner.

The modification of the pledge rule applies only to installment sales where the pledge rule of present law applies. Accordingly, the provision does not apply to installment method sales made by a dealer in timeshares and residential lots where the taxpayer elects to pay interest under section 453(l)(2)(B), to sales of property used or produced in the trade or business of farming, or to dispositions where the sales price does not exceed $150,000, since such sales are not subject to the pledge rule under present law.

Effective date.—The provision of the House bill is effective for sales or other dispositions entered into on or after the date of enactment.

Senate Amendment

Same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

I. Limitation on the Use of Non-accrual Experience Method of Accounting (sec. 1509 of the House bill, sec. 1311 of the Senate amendment, and sec. 448 of the Code)

Present Law

An accrual method taxpayer generally must recognize income when all the events have occurred that fix the right to receive the income and the amount of the income can be determined with reasonable accuracy. An accrual method taxpayer may deduct the amount of any receivable that was previously included in income that becomes worthless during the year.

Accrual method taxpayers are not required to include in income amounts to be received for the performance of services which, on the basis of experience, will not be collected (the "non-accrual experience method"). The availability of this method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount charged.

A cash method taxpayer is not required to include an amount in income until it is received. A taxpayer generally may not use the cash method if purchase, production, or sale of merchandise is an income producing factor. Such taxpayers generally are required to keep inventories and use an accrual method of accounting. In addition, corporations (and partnerships with corporate partners) generally may not use the cash method of accounting if their average annual gross receipts exceed $5 million. An exception to this $5 million rule is provided for qualified personal service corporations. A qualified personal service corporation is a corporation (1) substantially all of whose activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting and (2) substantially all of the stock of which is owned by current or former employees performing such services, their estates or heirs. Qualified personal service corporations are allowed to use the cash method without regard to whether their average annual gross receipts exceed $5 million.

House Bill

The House bill provides that the non-accrual experience method will be available only for amounts to be received for the performance of qualified personal services. Amounts to be received for the performance of all other services will be subject to the general rule regarding inclusion in income. Qualified personal services are personal services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts or consulting. As under present law, the availability of the method is conditioned on the taxpayer not charging interest or a penalty for failure to timely pay the amount.

Effective date.—The provision of the House bill is effective for taxable years ending after the date of enactment. Any change in the taxpayer's method of accounting necessitated as a result of the proposal will be treated as a voluntary change initiated by the taxpayer with the consent of the Secretary of the Treasury. Any required section 481(a) adjustment is to be taken into account over

a period not to exceed four years under principles consistent with those in Rev. Proc. 98–60.[190]

Senate Amendment

The Senate amendment is the same as the House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

J. Exclusion of Like-Kind Exchange Property from Nonrecognition Treatment on the Sale or Exchange of a Principal Residence (sec. 1510 of the House bill and sec. 121 of the Code)

Present Law

Under present law, a 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) that is equal to the fraction of the two years that the ownership and use requirements are met. There are no special rules relating to the sale or exchange of a principal residence that was acquired in a like-kind exchange within the prior five years.

House Bill

The House bill denies the principal residence exclusion (sec. 121) for gain on the sale or exchange of a principal residence if such principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years.

Effective date.—The House bill provision is effective for sales or exchanges of principal residences after the date of enactment.

Senate Amendment

No provision.

Conference Agreement

The conference agreement does not include the House bill provision.

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[190] 1998–51 I.R.B. 16.

K. Denial of Charitable Contribution Deduction for Transfers Associated with Split-Dollar Insurance Arrangements (sec. 1003 of the House bill, sec. 1315 of the Senate amendment, and new sec. 501(c)(28) of the Code)

Present Law

Under present law, in computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct charitable contributions paid during the taxable year. The amount of the deduction allowable for a taxable year with respect to any charitable contribution depends on the type of property contributed, the type of organization to which the property is contributed, and the income of the taxpayer (secs. 170(b) and 170(e)). A charitable contribution is defined to mean a contribution or gift to or for the use of a charitable organization or certain other entities (sec. 170(c)). The term "contribution or gift" is not defined by statute, but generally is interpreted to mean a voluntary transfer of money or other property without receipt of adequate consideration and with donative intent. If a taxpayer receives or expects to receive a quid pro quo in exchange for a transfer to charity, the taxpayer may be able to deduct the excess of the amount transferred over the fair market value of any benefit received in return, provided the excess payment is made with the intention of making a gift.[191]

In general, no charitable contribution deduction is allowed for a transfer to charity of less than the taxpayer's entire interest (i.e., a partial interest) in any property (sec. 170(f)(3)). In addition, no deduction is allowed for any contribution of $250 or more unless the taxpayer obtains a contemporaneous written acknowledgment from the donee organization that includes a description and good faith estimate of the value of any goods or services provided by the donee organization to the taxpayer in consideration, whole or part, for the taxpayer's contribution (sec. 170(f)(8)).

House Bill

Deduction denial

The House bill provision[192] restates present law to provide that no charitable contribution deduction is allowed for purposes of Federal tax, for a transfer to or for the use of an organization described in section 170(c) of the Internal Revenue Code, if in connection with the transfer (1) the organization directly or indirectly pays, or has previously paid, any premium on any "personal benefit contract" with respect to the transferor, or (2) there is an understanding or expectation that any person will directly or indirectly pay any premium on any "personal benefit contract" with respect to the transferor. It is intended that an organization be considered as indirectly paying premiums if, for example, another person pays premiums on its behalf.

A personal benefit contract with respect to the transferor is any life insurance, annuity, or endowment contract, if any direct or in-

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[191] *United States* v. *American Bar Endowment*, 477 U.S. 105 (1986). Treas. Reg. sec. 1.170A–1(h).

[192] The provision is similar to H.R. 630, introduced by Mr. Archer and Mr. Rangel (106th Cong., 1st Sess.).

direct beneficiary under the contract is the transferor, any member of the transferor's family, or any other person (other than a section 170(c) organization) designated by the transferor. For example, such a beneficiary would include a trust having a direct or indirect beneficiary who is the transferor or any member of the transferor's family, and would include an entity that is controlled by the transferor or any member of the transferor's family. It is intended that a beneficiary under the contract include any beneficiary under any side agreement relating to the contract. If a transferor contributes a life insurance contract to a section 170(c) organization and designates one or more section 170(c) organizations as the sole beneficiaries under the contract, generally, it is not intended that the deduction denial rule under the provision apply. If, however, there is an outstanding loan under the contract upon the transfer of the contract, then the transferor is considered as a beneficiary. The fact that a contract also has other direct or indirect beneficiaries (persons who are not the transferor or a family member, or designated by the transferor) does not prevent it from being a personal benefit contract. The provision is not intended to affect situations in which an organization pays premiums under a legitimate fringe benefit plan for employees.

It is intended that a person be considered as an indirect beneficiary under a contract if, for example, the person receives or will receive any economic benefit as a result of amounts paid under or with respect to the contract. For this purpose, as described below, an indirect beneficiary is not intended to include a person that benefits exclusively under a bona fide charitable gift annuity (within the meaning of sec. 501(m)).

In the case of a charitable gift annuity, if the charitable organization purchases an annuity contract issued by an insurance company to fund its obligation to pay the charitable gift annuity, a person receiving payments under the charitable gift annuity is not treated as an indirect beneficiary, provided certain requirements are met. The requirements are that (1) the charitable organization possess all of the incidents of ownership (within the meaning of Treas. Reg. sec. 20.2042–1(c)) under the annuity contract purchased by the charitable organization; (2) the charitable organization be entitled to all the payments under the contract; and (3) the timing and amount of payments under the contract be substantially the same as the timing and amount of payments to each person under the organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

Under the provision, an individual's family consists of the individual's grandparents, the grandparents of the individual's spouse, the lineal descendants of such grandparents, and any spouse of such a lineal descendant.

In the case of a charitable gift annuity obligation that is issued under the laws of a State that requires, in order for the charitable gift annuity to be exempt from insurance regulation by that State, that each beneficiary under the charitable gift annuity be named as a beneficiary under an annuity contract issued by an insurance company authorized to transact business in that State, then the foregoing requirements (1) and (2) are treated as if they are met,

provided that certain additional requirements are met. The additional requirements are that the State law requirement was in effect on February 8, 1999, each beneficiary under the charitable gift annuity is a bona fide resident of the State at the time the charitable gift annuity was issued, the only persons entitled to payments under the annuity contract issued by the insurance company are persons entitled to payments under the charitable gift annuity when it was issued, and (as required by clause (iii) of subparagraph (D) of the provision) the timing and amount of payments under the annuity contract to each person are substantially the same as the timing and amount of payments to the person under the charitable organization's obligation under the charitable gift annuity (as in effect at the time of the transfer to the charitable organization).

In the case of a charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)) that holds a life insurance, endowment or annuity contract issued by an insurance company, a person is not treated as an indirect beneficiary under the contract held by the trust, solely by reason of being a recipient of an annuity or unitrust amount paid by the trust, provided that the trust possesses all of the incidents of ownership under the contract and is entitled to all the payments under such contract. No inference is intended as to the applicability of other provisions of the Code with respect to the acquisition by the trust of a life insurance, endowment or annuity contract, or the appropriateness of such an investment by a charitable remainder trust.

Nothing in the provision is intended to suggest that a life insurance, endowment, or annuity contract would be a personal benefit contract, solely because an individual who is a recipient of an annuity or unitrust amount paid by a charitable remainder annuity trust or charitable remainder unitrust uses such a payment to purchase a life insurance, endowment or annuity contract, and a beneficiary under the contract is the recipient, a member of his or her family, or another person he or she designates.

Excise tax

The provision imposes on any organization described in section 170(c) of the Code an excise tax, equal to the amount of the premiums paid by the organization on any life insurance, annuity, or endowment contract, if the premiums are paid in connection with a transfer for which a deduction is not allowable under the deduction denial rule of the provision (without regard to when the transfer to the charitable organization was made). The excise tax does not apply if all of the direct and indirect beneficiaries under the contract (including any related side agreement) are organizations described in section 170(c). Under the provision, payments are treated as made by the organization, if they are made by any other person pursuant to an understanding or expectation of payment. The excise tax is to be applied taking into account rules ordinarily applicable to excise taxes in chapter 41 or 42 of the Code (e.g., statute of limitation rules).

Reporting

The provision requires that the charitable organization annually report the amount of premiums that is paid during the year

and that is subject to the excise tax imposed under the provision, and the name and taxpayer identification number of each beneficiary under the life insurance, annuity or endowment contract to which the premiums relate, as well as other information required by the Secretary of the Treasury. For this purpose, it is intended that a beneficiary include any beneficiary under any side agreement to which the section 170(c) organization is a party (or of which it is otherwise aware). Penalties applicable to returns required under Code section 6033 apply to returns under this reporting requirement. Returns required under this provision are to be furnished at such time and in such manner as the Secretary shall by forms or regulations require.

Regulations

The provision provides for the promulgation of regulations necessary or appropriate to carry out the purposes of the provisions, including regulations to prevent the avoidance of the purposes of the provision. For example, it is intended that regulations prevent avoidance of the purposes of the provision by inappropriate or improper reliance on the limited exceptions provided for certain beneficiaries under *bona fide* charitable gift annuities and for certain noncharitable recipients of an annuity or unitrust amount paid by a charitable remainder trust.

Effective date

The deduction denial provision applies to transfers after February 8, 1999 (as provided in H.R. 630). The excise tax provision applies to premiums paid after the date of enactment. The reporting provision applies to premiums paid after February 8, 1999 (determined as if the excise tax imposed under the provision applied to premiums paid after that date).

No inference is intended that a charitable contribution deduction is allowed under present law with respect to a charitable split-dollar insurance arrangement. The provision does not change the rules with respect to fraud or criminal or civil penalties under present law; thus, actions constituting fraud or that are subject to penalties under present law would still constitute fraud or be subject to the penalties after enactment of the provision.

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement follows the House bill and the Senate amendment.

L. Modify Foreign Tax Credit Carryover Rules (sec. 1301 of the Senate amendment and sec. 904 of the Code)

Present Law

U.S. persons may credit foreign taxes against U.S. tax on foreign-source income. The amount of foreign tax credits that can be claimed in a year is subject to a limitation that prevents taxpayers

from using foreign tax credits to offset U.S. tax on U.S.-source income. Separate foreign tax credit limitations are applied to specific categories of income.

The amount of creditable taxes paid or accrued (or deemed paid) in any taxable year which exceeds the foreign tax credit limitation is permitted to be carried back two years and forward five years. The amount carried over may be used as a credit in a carryover year to the extent the taxpayer otherwise has excess foreign tax credit limitation for such year. The separate foreign tax credit limitations apply for purposes of the carryover rules.

House Bill

No provision.

Senate Amendment

The Senate amendment reduces the carryback period for excess foreign tax credits from two years to one year. The Senate amendment also extends the excess foreign tax credit carryforward period from five years to seven years.

Effective date.—The provision applies to foreign tax credits arising in taxable years beginning after December 31, 1999.

Conference Agreement

The conference agreement does not include the provision in the Senate amendment.

M. Modify Estimated Tax Rules for Closely Held REIT Dividends (sec. 1316 of the Senate amendment and sec. 6655 of the Code)

Present Law

If a person has a direct interest or a partnership interest in income-producing assets (such as securities generally, or mortgages) that produce income throughout the year, that person's estimated tax payments must reflect the quarterly amounts expected from the asset.

However, a dividend distribution of earnings from a REIT is considered for estimated tax purposes when the dividend is paid. Some corporations have established closely held REITS that hold property (e.g. mortgages) that if held directly by the controlling entity would produce income throughout the year. The REIT may make a single distribution for the year, timed such that it need not be taken into account under the estimated tax rules as early as would be the case if the assets were directly held by the controlling entity. The controlling entity thus defers the payment of estimated taxes.

House Bill

No provision.

Senate Amendment

In the case of a REIT that is closely held, any person owning at least 10 percent of the vote or value of the REIT is required to accelerate the recognition of year-end dividends attributable to the closely held REIT, for purposes of such person's estimated tax payments. A closely held REIT is defined as one in which at least 50 percent of the vote or value is owed by five or fewer persons. Attribution rules apply to determine ownership.

No inference is intended regarding the treatment of any transaction prior to the effective date.

Effective date.—The provision is effective for estimated tax payments due on or after September 15, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

N. Prohibited Allocations of Stock in an S Corporation ESOP (sec. 1317 of the Senate amendment and secs. 409 and 4979A of the Code)

Present Law

The Small Business Job Protection Act of 1996 allowed qualified retirement plan trusts described in section 401(a) to own stock in an S corporation. That Act treated the plan's share of the S corporation's income (and gain on the disposition of the stock) as includible in full in the trust's unrelated business taxable income ("UBTI").

The Tax Relief Act of 1997 repealed the provision treating items of income or loss of an S corporation as UBTI in the case of an employee stock ownership plan ("ESOP"). Thus, the income of an S corporation allocable to an ESOP is not subject to current taxation.

Present law provides a deferral of income on the sales of certain employer securities to an ESOP (sec. 1042). A 50-percent excise tax is imposed on certain prohibited allocations of securities acquired by an ESOP in a transaction to which section 1042 applies. In addition, such allocations are currently includible in the gross income of the individual receiving the prohibited allocation.

House Bill

No provision.

Senate Amendment

Under the provision, if there is a prohibited allocation of stock to a disqualified person under an ESOP sponsored by an S corporation (a "Sub S ESOP") for a nonallocation year: (1) an excise tax is imposed on the employer equal to 50 percent of the amount involved in the prohibited allocation; and (2) the stock allocated in the prohibited allocation is treated as distributed to the disqualified individual.

A nonallocation year means any plan year of a Sub S ESOP if, at any time during the plan year, disqualified individuals own

at least 50 percent of the number of outstanding shares of the S corporation.

An individual is a disqualified person if the individual is either (1) a member of a "deemed 20-percent shareholder group" or (2) a "deemed 10-percent shareholder". An individual is a member of a "deemed 20-percent shareholder group" if the number of deemed-owned shares of the individual and his or her family members is at least 20 percent of the number of outstanding shares of the corporation. An individual is a deemed 10-percent shareholder if the individual is not a member of a deemed 20-percent shareholder group and the number of the individual's deemed-owned shares is at least 10 percent of the number of outstanding shares of stock of the corporation.

"Deemed-owned shares" mean: (1) stock allocated to the account of the individual under the ESOP, and (2) the individual's share of unallocated stock held by the ESOP. An individual's share of unallocated stock held by an ESOP is determined in the same manner as the most recent allocation of stock under the terms of the plan.

For purposes of determining whether disqualified individuals own 50 percent or more of the outstanding stock of the corporation, deemed-owned shares and shares owned directly by an individual are taken into account. The family attribution rules of section 318 would apply, modified to include certain other family members, as described below.

Under the provision, family members of an individual include (1) the spouse of the individual, (2) an ancestor or lineal descendant of the individual or his or her spouse, (3) a sibling of the individual (or the individual's spouse) and any lineal descendant of the brother or sister, and (4) the spouse of any person described in (2) or (3).

The Secretary is directed to prescribe rules under which holders of options, restricted stock and similar interests are or are not treated as owning stock attributable to such interests as appropriate to carry out the purposes of the provision. For example, it is intended that such interests would be taken into account if so doing would result in disqualified individuals owning at least 50 percent of the stock of the corporation and that such interests would not be taken into account if so doing would result in disqualified individuals owning less than 50 percent of the stock of the corporation.

Effective date.—The provision is generally effective with respect to years beginning after December 31, 2000. In the case of an ESOP established after July 14, 1999, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the provision is effective with respect to plan years ending after July 14, 1999.

Conference Agreement

The conference agreement does not include the Senate amendment.

The conferees remain concerned that ESOPs of S corporations may continue to be used to avoid or inappropriately defer taxes. Thus, the conferees view the provision as a first step in addressing

possible tax avoidance issues relating to the use of S corporation ESOPs and believe that further study of these issues, and further legislation, may be appropriate.

O. Modify Anti-abuse Rules Related to Assumption of Liabilities (sec. 1318 of the Senate amendment and sec. 357 of the Code)

Present Law

Generally, no gain or loss is recognized if property is exchanged for stock of a controlled corporation. The transferor may recognize gain to the extent other property ("boot") is received by the transferor. The assumption of liabilities by the transferee generally is not treated as boot received by the transferor. The assumption of a liability is treated as boot to the transferor, however, "[i]f, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer . . . was a purpose to avoid Federal income tax on the exchange, or . . . if not such purpose, was not a bona fide business purpose." Sec. 357(b). Thus, this exception requires that the principal purpose of having the transferee assume the liability was the avoidance of tax on the exchange.

The transferor's basis in the stock of the transferee received in the exchange is the basis of the property contributed, reduced by the amount of any liability assumed, but generally increased in the amount of any gain recognized by the transferor on the exchange. If the transferee assumes liabilities in excess of the basis of assets transferred, the transferor recognizes gain in the amount of the excess. However, this gain recognition rule does not apply if the assumption of a liability is treated as boot under the tax avoidance rule. Stock basis is reduced, however, for such an assumption.[193] For other liabilities (where the assumption is not treated as boot under the tax avoidance rule), no gain recognition or basis reduction is required for the assumption of a liability that would give rise to a deduction.

Similar rules apply in connection with certain tax-free reorganizations.

A different set of rules applies with respect to partnerships. However, generally a partner's basis in its partnership interest is the basis of property contributed. Liabilities affect that basis by causing a decrease in basis of the partnership interest to the extent the partnership has assumed the partner's liabilities, and an increase in basis to the extent the partner has assumed liabilities of the partnership. Similarly, there is an increase (or decrease) in basis for an increase (or decrease) in the partner's share of partnership liabilities.

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[193] Pursuant to section 357(c)92)(A), liabilities that are treated as assumed in a tax avoidance transaction under section 357(b)(1) are not within the scope of section 357(c)(3) or section 358(d)(2) under present law. Thus, the transferee's assumption of a liability that is treated as a tax avoidance transaction under section 357(b)(1) is treated as the transferor's receipt of money for purposes of 358 and related provisions, regardless of whether the liability would give rise to a deduction.

House Bill

No provision.

Senate Amendment

The Senate amendment deletes the limitation that the assumption of liabilities anti-abuse rule only applies to tax avoidance on the exchange itself, and changes "the principal purpose" standard to "a principal purpose." The provision also affects the basis rule that requires a decrease in the transferor's basis in the transferee's stock when a liability, the payment of which would give rise to a deduction, is treated as boot under the tax avoidance rule. The committee report refers to a specific type of transaction involving certain contingent liabilities as one example of a transaction that is of concern under present law.

Effective date.—The provision is effective for assumptions of liabilities on or after July 15, 1999.

Conference Agreement

The conference agreement follows the Senate amendment.

It is also expected that the Treasury Department will promptly examine the use of partnerships and apply similar rules (for example, with respect to adjustments to the basis of a partnership interest with respect to certain contingent liabilities) where there is a principal purpose of avoiding Federal income tax through the use of a transaction that includes the assumption of liabilities by a partnership. The conferees note that pursuant to section 7805(b)(3), if necessary to prevent abuse, the Secretary could determine that any regulations applying such rules should be effective on the same date as this provision, i.e., July 15, 1999.

No inference is intended regarding the proper treatment of any transaction under present law.

Effective date.—The effective date is the same as that of the Senate amendment.

P. Require Consistent Treatment and Provide Basis Allocation Rules for Transfers of Intangibles in Certain Nonrecognition Transactions (sec. 1319 of the Senate amendment and secs. 351 and 721 of the Code)

Present Law

Generally, no gain or loss is recognized if one or more persons transfer property to a corporation solely in exchange for stock in the corporation and, immediately after the exchange such person or persons are in control of the corporation. Similarly, no gain or loss is recognized in the case of a contribution of property in exchange for a partnership interest. Neither the Internal Revenue Code nor the regulations provide the meaning of the requirement that a person "transfer property" in exchange for stock (or a partnership interest). The Internal Revenue Service interprets the requirement consistent with the "sale or other disposition of property" language in the context of a taxable disposition of property. See, e.g., Rev. Rul. 69–156, 1969–1 C.B. 101. Thus, a transfer of less than "all

substantial rights" to use property will not qualify as a tax-free exchange and stock received will be treated as payments for the use of property rather than for the property itself. These amounts are characterized as ordinary income. However, the Claims Court has rejected the Service's position and held that the transfer of a nonexclusive license to use a patent (or any transfer of "something of value") could be a "transfer" of "property" for purposes of the nonrecognition provision. See *E.I. DuPont de Nemours & Co.* v. *U.S.,* 471 F.2d 1211 (Ct. Cl. 1973).

House Bill

No provision.

Senate Amendment

The provision treats a transfer of an interest in intangible property constituting less than all of the substantial rights of the transferor in the property as a transfer of property for purposes of the nonrecognition provisions regarding transfers of property to controlled corporations and partnerships. In the case of a transfer of less than all of the substantial rights, the transferor is required to allocate the basis of the intangible between the retained rights and the transferred rights based upon their respective fair market values.

No inference is intended as to the treatment of these or similar transactions prior to the effective date.

Effective date.—The provision is effective for transfers on or after the date of enactment.

Conference Agreement

The conference agreement follows the Senate amendment.

Q. Distributions by a Partnership to a Corporate Partner of Stock in Another Corporation (sec. 1321 of the Senate amendment and sec. 732 of the Code)

Present Law

Present law generally provides that no gain or loss is recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation in which it holds 80 percent of the stock (by vote and value) (sec. 332). The basis of property received by a corporate distributee in the distribution in complete liquidation of the 80-percent-owned subsidiary is a carryover basis, i.e., the same as the basis in the hands of the subsidiary (provided no gain or loss is recognized by the liquidating corporation with respect to the distributed property) (sec. 334(b)).

Present law provides two different rules for determining a partner's basis in distributed property, depending on whether or not the distribution is in liquidation of the partner's interest in the partnership. Generally, a substituted basis rule applies to property distributed to a partner in liquidation. Thus, the basis of property distributed in liquidation of a partner's interest is equal to the partner's adjusted basis in its partnership interest (reduced by any money distributed in the same transaction) (sec. 732(b)).

By contrast, generally, a carryover basis rule applies to property distributed to a partner other than in liquidation of its partnership interest, subject to a cap (sec. 732(a)). Thus, in a non-liquidating distribution, the distributee partner's basis in the property is equal to the partnership's adjusted basis in the property immediately before the distribution, but not to exceed the partner's adjusted basis in its partnership interest (reduced by any money distributed in the same transaction). In a non-liquidating distribution, the partner's basis in its partnership interest is reduced by the amount of the basis to the distributee partner of the property distributed and is reduced by the amount of any money distributed (sec. 733).

If corporate stock is distributed by a partnership to a corporate partner with a low basis in its partnership interest, the basis of the stock is reduced in the hands of the partner so that the stock basis equals the distributee partner's adjusted basis in its partnership interest. No comparable reduction is made in the basis of the corporation's assets, however. The effect of reducing the stock basis can be negated by a subsequent liquidation of the corporation under section 332.[194]

House Bill

No provision.

Senate Amendment

In general

The provision provides for a basis reduction to assets of a corporation, if stock in that corporation is distributed by a partnership to a corporate partner. The reduction applies if, after the distribution, the corporate partner controls the distributed corporation.

Amount of the basis reduction

Under the provision, the amount of the reduction in basis of property of the distributed corporation generally equals the amount of the excess of (1) the partnership's adjusted basis in the stock of the distributed corporation immediately before the distribution, over (2) the corporate partner's basis in that stock immediately after the distribution.

The provision limits the amount of the basis reduction in two respects. First, the amount of the basis reduction may not exceed the amount by which (1) the sum of the aggregate adjusted bases of the property and the amount of money of the distributed corporation exceeds (2) the corporate partner's adjusted basis in the stock of the distributed corporation. Thus, for example, if the distributed corporation has cash of $300 and other property with a basis of $600 and the corporate partner's basis in the stock of the distributed corporation is $400, then the amount of the basis reduction could not exceed $500 (i.e., ($300+$600) − $400 = $500).

[194] In a similar situation involving the purchase of stock of a subsidiary corporation as replacement property following an involuntary conversion, the Code generally requires the basis of the assets held by the subsidiary to be reduced to the extent that the basis of the stock in the replacement corporation itself is reduced (sec. 1033).

Second, the amount of the basis reduction may not exceed the adjusted basis of the property of the distributed corporation. Thus, the basis of property (other than money) of the distributed corporation may not be reduced below zero under the provision, even though the total amount of the basis reduction would otherwise be greater.

The provision provides that the corporate partner recognizes long-term capital gain to the extent the amount of the basis reduction does exceed the basis of the property (other than money) of the distributed corporation. In addition, the corporate partner's adjusted basis in the stock of the distribution is increased in the same amount. For example, if the amount of the basis reduction were $400, and the distributed corporation has money of $200 and other property with an adjusted basis of $300, then the corporate partner would recognize a $100 capital gain under the provision. The corporate partner's basis in the stock of the distributed corporation would also be increased by $100 in this example, under the provision.

The basis reduction is to be allocated among assets of the controlled corporation in accordance with the rules provided under section 732(c).

Partnership distributions resulting in control

The basis reduction generally applies with respect to a partnership distribution of stock if the corporate partner controls the distributed corporation immediately after the distribution or at any time thereafter. For this purpose, the term control means ownership of stock meeting the requirements of section 1504(a)(2) (generally, an 80-percent vote and value requirement).

The provision applies to reduce the basis of any property held by the distributed corporation immediately after the distribution, or, if the corporate partner does not control the distributed corporation at that time, then at the time the corporate partner first has such control. The provision does not apply to any distribution if the corporate partner does not have control of the distributed corporation immediately after the distribution and establishes that the distribution was not part of a plan or arrangement to acquire control.

Under the provision, a corporation is treated as receiving a distribution of stock from a partnership, if the corporation acquires stock other than in a distribution from a partnership and the basis of the stock is determined in whole or in part by reference to the partnership rules limiting the basis of the stock to a partner's basis in his partnership interest (secs. 732(a)(2) or 732(b)).

In the case of tiered corporations, a special rule provides that if the property held by a distributed corporation is stock in a corporation that the distributed corporation controls, then the provision is applied to reduce the basis of the property of that controlled corporation. The provision is also reapplied to any property of any controlled corporation that is stock in a corporation that it controls. Thus, for example, if stock of a controlled corporation is distributed to a corporate partner, and the controlled corporation has a subsidiary, the amount of the basis reduction allocable to stock of the subsidiary is applied again to reduce the basis of the assets of the subsidiary, under the special rule.

Effective date

The provision is effective for distributions made after July 14, 1999.

Conference Agreement

The conference agreement follows the Senate amendment, with clarifications and with a modification to the effective date.

The conference agreement clarifies the rule relating to stock acquired other than in a distribution from a partnership when the basis of the stock is determined in whole or in part by reference to the partnership rules limiting the basis of the stock to a partner's basis in his partnership interest (secs. 732(a)(2) or 732(b)). As clarified, the rule provides that, for purposes of the provision, if a corporation acquires (other than in a distribution from a partnership) stock the basis of which is determined (by reason of being distributed from a partnership) in whole or in part by reference to section 732(a)(2) or (b), then the corporation is treated as receiving a distribution of stock from a partnership. For example, if a partnership distributes property other than stock (such as real estate) to a corporate partner, and that corporate partner contributes the real estate to another corporation in a section 351 transaction, then the stock received in the section 351 transaction is not treated as distributed by a partnership, and the basis reduction under this provision does not apply. As another example, if a partnership distributes stock to two corporate partners, neither of which have control of the distributed corporation, and the two corporate partners merge and the survivor obtains control of the distributed corporation, the stock of the distributed corporation that is acquired as a result of the merger is treated as received in a partnership distribution; the basis reduction rule of the provision applies.

The conference agreement also provides additional clarification with respect to the regulations under the provision (which include regulations to avoid double counting and to prevent the abuse of the purposes of the provision). The conferees intend that regulations prevent the avoidance of the purposes of the provision through the use of tiered partnerships.

Effective date.—The provision is effective for distributions made after July 14, 1999, except that in the case of a corporation that is a partner in a partnership on July 14, 1999, the provision is effective for distributions by that partnership to the corporation after the date of enactment.

XVII. TAX TECHNICAL CORRECTIONS (secs. 1601–1605 of the House bill and secs. 504(c) and 1401–1405 of the Senate amendment)

House Bill

The House bill contains technical, clerical and conforming amendments to the Tax and Trade Relief Extension Act of 1998 and other recently enacted legislation. The provisions generally are

effective as if enacted in the original legislation to which each provision relates.[195]

Senate Amendment

Same as House bill.

Conference Agreement

The conference agreement does not include the House bill or the Senate amendment provisions.

XVIII. SENSE OF THE SENATE AND OTHER PROVISIONS

A. Sense of the Congress Regarding Empowerment Zones (sec. 1128 of the Senate amendment)

Present Law

Pursuant to the Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") and the Taxpayer Relief Act of 1997 ("1997 Act"), the Secretaries of the Department of Housing and Urban Development and the Department of Agriculture have designated a number of areas as empowerment zones and enterprise communities. In general, businesses located in empowerment zones and enterprise communities qualify for certain tax incentives (though the empowerment zones designated in the 1997 Act are not necessarily entitled to all of the tax incentives as those designated in OBRA 1993).

The Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act for Fiscal Year 1999 appropriated funds for 20 new rural enterprise communities that meet the designation and eligibility requirements set out the Code (but are not designated as enterprise communities for Federal tax purposes).

House Bill

No provision.

Senate Amendment

The Senate amendment provides a Sense of the Congress resolution that if Congress and the President agree to a substantial tax relief measure, it should ensure that such tax relief measure includes full funding for the empowerment zones and enterprise communities authorized in 1997 and 1998, as well as those areas currently designated as rural economic area partnerships by the Department of Agriculture. In addition, all such designated areas should equally share at least the same aggregate level of funding, tax incentives, and other Federal support that Congress provided to urban and rural empowerment zones and enterprise communities authorized by OBRA 1993.

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[195] For a description of the House provisions, see H. Rept. 106–238 (H.R. 2488), July 16, 1999.

Conference Agreement

The conference agreement does not include the Senate amendment.

B. Sense of the Senate Regarding Savings Incentives (sec. 1127 of the Senate amendment)

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 gross income and subject to tax.

House Bill

No provision.

Senate Amendment

The Senate amendment states that, before December 31, 1999, Congress should pass legislation that creates savings incentives by providing a partial Federal income tax exclusion for income derived from interest and dividends of no less than $400 for married taxpayers and $200 for single taxpayers.

Effective date.—The provision is effective upon enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

C. Sense of the Congress Regarding Small Business Incentives (sec. 1129 of the Senate amendment)

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 $19,000 (for taxable years beginning in 1999) 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 $19,000 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 $19,000 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 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.

House Bill

No provision.

Senate Amendment

The Senate amendment states that it is the sense of the Congress that many small businesses would benefit from the expansion of present-law expensing provisions to cover investments in depreciable real property, and that Congress should consider such expansion in any reform legislation that follows the depreciation study that the Treasury Department is currently undertaking.

Effective date.—The provision is effective upon enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

D. Direct Expenditure Block Grant (sec. 1126 of the Senate amendment and sec. 418 of the Social Security Act)

Present Law

Section 418 of the Social Security Act provides grants to the States for the purpose of providing child care assistance. At least 70 percent of the amounts received by the States must be used to provide child care assistance to families who are receiving assistance under a State program of Temporary Assistance for Needy Families (Title IV, part A of the Social Security Act), to families who are attempting through work activities to transition off of such assistance program, or to families who are at risk of becoming dependent on such assistance program.

House Bill

No provision.

Senate Amendment

The Senate amendment increases appropriations for grants under Section 418 of the Social Security Act from $2,717 million to $3,918 million for fiscal year 2002, and provides appropriations of $3,979 million for fiscal year 2003, $4,010 million for fiscal year 2004, $3,860 million for fiscal year 2005, $3,954 million for fiscal year 2006, $4,004 million for fiscal year 2007, $4,073 million for fiscal year 2008, and $4,075 million for fiscal year 2009.

Effective date.—The provision is effective upon enactment.

Conference Agreement

The conference agreement does not include the Senate amendment.

XIX. CONTINGENCY FOR RATE REDUCTIONS AND COMMITMENT TO DEBT REDUCTION (secs. 101 and 1701 of the House bill)

Present Law

No provision.

House Bill

The House-passed version contained a 10-percent across-the-board rate reduction. The trigger attached to these provisions would delay the scheduled reductions in these rates depending on the level of gross interest costs. Gross interest expenses accrue from debt held publically as well as debt held by all government trust funds.

In order for a rate reduction to occur on January 1, the government's gross interest expense during the 12 month period ending on July 31 of the previous year must not increase. This measurement is referred to in the bill as the debt reduction calendar year. If the gross interest expense increased, the tax rate reduction was delayed one year but previous rate reductions were not rescinded.

The across the board rate reduction scheduled to take place in 2001 was not subject to the trigger.

The House bill contained a provision reflecting the sense of the Congress that the national debt held by the public shall be reduced from $3.619 trillion to a level below $1.61 trillion by fiscal year 2009.

Senate Amendment

No provision.

Conference Agreement

The conference report contains the same trigger mechanism as in the House passed bill. The trigger mechanism is based on gross debt interest expenses which must not increase from the previous year through July 31 of the year before the scheduled increase.

The conference report, however, contains a different structure for reducing tax rates and expanding certain tax brackets. In three instances, the trigger may delay one or more of these provisions. The following items are subject to the trigger mechanism:

—In 2003, the 14.5 percent marginal tax rate will be reduced to 14.0 percent.

—In 2005, the top four marginal tax rates will each be reduced by 1 percentage point.

—In 2006, the width of the 14 percent tax bracket will be increased by $5,000.

The first rate reduction from 15 percent to 14.5 percent is permanent and not subject to the trigger.

In addition, the conferees express the sense of the Congress that: (1) the national debt of the United States held by the public is $3.619 trillion as of fiscal year 1999; (2) the Federal budget is projected to produce a surplus each year in the next 10 fiscal years; (3) refunding taxes and reducing the national debt held by the pub-

lic will assure continued economic growth and financial freedom for future generations; and (4) The provision reflects the sense of the Congress that: (1) the national debt of the United States held by the public is $3.619 trillion as of fiscal year 1999; (2) the Federal budget is projected to produce a surplus each year in the next 10 fiscal years; (3) refunding taxes and reducing the national debt held by the public will assure continued economic growth and financial freedom for future generations; and (4) the national debt held by the public shall be reduced from $3.619 trillion to a level below $1.61 trillion by fiscal year 2009.

XX. EXCLUSION FROM PAYGO SCORECARD (sec. 1801 of the House bill)

Present Law

Under the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, tax reduction legislation is subject to a "pay-as-you-go" (PAYGO) requirement. The PAYGO system tracks legislation that may increase budget deficits using a "scorecard" (estimated by the Office of Management and Budget). Any revenue loss would have to be offset by other revenue increases, reductions in direct spending or a combination of the two.

House Bill

The House bill provides that, upon enactment of the Act, the Director of the Office of Management and Budget shall not make any estimate of the changes in direct spending outlays and receipts under section 252(d) of the Balanced Budget and Emergency Deficit Control Act of 1985 resulting from the enactment of the Act.

Senate Amendment

No provision.

Conference Agreement

The conference agreement follows the Senate amendment due to the Senate's procedural requirements under the Byrd rule. The conferees note that the reduction in revenues from the conference agreement is fully accommodated under the Congressional budget resolution from the on-budget non-social security surplus, leaving greater amounts set aside for Social Security, Medicare and debt relief greater than under the President's budget. The conferees further believe that the application of current PAYGO rules to the conference report is anachronistic in an era of sustained projected surpluses. Therefore, the conferees intend that, upon enactment of the Act, the Director of OMB should be directed to not make any estimate of the changes in direct spending, outlays, and receipts under section 252(d) of the Balanced Budget and Emergency Deficit Control Act of 1985 resulting from the enactment of the Act.

XXI. COMPLIANCE WITH CONGRESSIONAL BUDGET ACT (sec. 1501 of the Senate amendment)

Present Law

Reconciliation is a procedure under the Congressional Budget Act of 1974 ("the Budget Act") by which Congress implements spending and tax policies contained in a budget resolution. The Budget Act contains numerous rules enforcing the scope of items permitted to be considered under budget reconciliation process. One such rule, the so-called "Byrd rule," was incorporated into the Budget Act in 1990. The Byrd rule, named after its principal sponsor, Senator Robert C. Byrd, is contained in section 313 of the Budget Act. The Byrd rule is generally interpreted to permit members to make a motion to strike extraneous provisions (those which are unrelated to the deficit reduction goals of the reconciliation process) from either a budget reconciliation bill or a conference report on such bill.

Under the Byrd rule, a provision is considered to be extraneous if it falls under one or more of the following six definitions:

(1) It does not produce a change in outlays or revenues;

(2) It produces an outlay increase or revenue decrease when the instructed committee is not in compliance with its instructions;

(3) It is outside of the jurisdiction of the committee that submitted the title or provision for inclusion in the reconciliation measure;

(4) It produces a change in outlays or revenues which is merely incidental to the non-budgetary components of the provision;

(5) It would increase the deficit for a fiscal year beyond those covered by the reconciliation measure; and

(6) it recommends changes in Social Security.

House Bill

No provision.

Senate Amendment

To ensure compliance with the Budget Act, the provision provides that all provisions of, and amendments made by, this Senate amendment, which are in effect on September 30, 2009, shall cease to apply as of such date, and shall begin to apply again as of October 1, 2009.

Conference Agreement

The conference agreement follows the Senate amendment, but provides that certain provisions of the bill sunset on December 31, 2008.

XXII. TAX COMPLEXITY ANALYSIS

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service ("IRS") and the Treasury Department) to provide a com-

plexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided, along with an estimate of the number and the type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS regarding each of the provisions included in the complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

1. Reduce the income tax rates (sec. 101 of the conference agreement)

Summary description of provision

The provision reduces the individual regular income tax rates as follows: (1) from 15 percent to 14 percent; (2) from 28 percent to 27 percent; (3) from 31 percent to 30 percent; (4) from 36 percent to 35 percent; and (5) from 39.6 percent to 38.6 percent. The reduction of the 15-percent rate to a 14-percent rate is phased-in over three years; (1) 14.5 percent in 2001 and 2002; and (2) 14 percent in 2003 and thereafter. The reductions in the other rates are effective for taxable years beginning after 2004. The provision also widens the lowest regular income tax bracket for singles and head of households by $3,000 for taxable years beginning after 2005. For years after 2006, the $3,000 amount is indexed for inflation.

Number of affected taxpayers

It is estimated that the reduction of the regular income tax rates will affect approximately 112 million individual income tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The information necessary to implement the provision will be readily available to taxpayers (in the form of new tax tables and tax rate schedules). The rate reduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision.

Because the provision includes corresponding reductions in the individual alternative minimum tax rates, the provision should not result in taxpayers having to calculate their tax liability under the alternative minimum tax (AMT).

2. Marriage penalty relief (sec. 111 of the conference agreement)

Summary description of provision

The provision increases the basic standard deduction for a married couple filing a joint return to twice the basic standard de-

duction for an unmarried individual. This increase is phased-in over five years (2001–2005) and is fully effective in 2005. The provision also increases the size of the lowest regular income tax rate bracket to twice the size of the rate bracket for an unmarried individual. This increase in the rate bracket is phased-in over four years (2005–2008) and is fully effective in 2008.

Number of affected taxpayers

It is estimated that this provision will affect approximately 36 million individual income tax returns.

Discussion

The provision is not expected to result in an increase in disputes with the IRS, nor should regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals' tax preparation costs. Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. Such taxpayers will no longer have to file Schedule A or need to engage in the record keeping inherent in itemizing below-the-line deductions. This reduction in complexity and record keeping may also result in a decline in the number of individuals using a tax preparation service (or a decline in the cost of using such a service). It may also reduce the number of disputes between taxpayers and the IRS regarding substantiation of itemized deductions.

3. Individual capital gains rates (secs. 201 and 202 of the conference agreement)

Summary description of provision

The provision reduces the present-law individual capital gain rates of 10, 20, and 25 percent to 8, 18, and 23 percent respectively, effective for transactions on or after January 1, 1999. The provision also provides for the indexation of capital gains beginning in 2000 (with mark-to-market treatment with respect to assets held on January 1, 2000).

Number of affected taxpayers

It is estimated that the provision will affect approximately 20 million individual income tax returns.

Discussion

The capital gains rate reductions are not expected to cause taxpayers to keep additional records. The repeal of the reduced rates for five-year property after 2000 will simplify the forms and recordkeeping for years after 2000. In addition, since the provision applies with respect to capital gains realized for all of 1999, it obviates the need for multiple rate schedules for 1999.

Indexing of assets for inflation beginning in 2000 is expected to cause taxpayers to keep additional records because, in the case of the disposition of capital assets held more than one year, it will be necessary to establish the calendar quarter in which the asset was purchased. The taxpayer will have the additional complexity of computing the basis adjustments on the sale of the assets by

multiplying the basis by the inflation adjustment. This will be particularly complex where assets are purchased periodically, such as in the case of common stock acquired pursuant to dividend reinvestment plans.

The indexing of assets will result in additional computations by the taxpayer, and guidance will be necessary to implement the provision. For example, guidance will be necessary with respect to assets that are held on January 1, 2000 that are marked-to-market, as well as the application of the indexing provision with respect to pass-through entities.

The indexing of assets may result in an increase in disputes with the IRS. The provision can be expected to increase the tax preparation cost of individuals using a tax preparation service, depending on the type of assets that are indexed and the extent to which a taxpayer maintains adequate records.

4. Increase in IRA contribution limit (sec. 211 of the conference agreement)

Summary description of provision

The provision increases the $2,000 IRA contribution limit to $3,000 for 2001–03, to $4,000 in 2004–05, to $5,000 in 2006–08.

Number of affected taxpayers

It is estimated that the provision will affect 15 million individual tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to the provision. It is not anticipated that the provision will result in increased disputes with the IRS. It is not anticipated that the provision will increase tax return preparation costs. Regulatory guidance will not be needed to implement the provision. Because the maximum contribution limit will change, some taxpayers may be confused as to how much they can contribute to an IRA. It is expected that IRS Forms and publications will contain the limit applicable for each year.

5. Accelerate 100-percent self-employed health insurance deduction (sec. 801 of the conference agreement)

Summary description of provision

The provision accelerates the increase in the deduction for health insurance expenses of self-employed individuals so that the deduction is 100 percent in years beginning after December 31, 1999.

Number of affected taxpayers

It is estimated that the provision will affect three million small businesses.

Discussion

It is not anticipated that individuals or small businesses will need to keep additional records due to the provision. It is not anticipated that the provision will result in an increase in disputes

with the IRS, or increase tax return preparation costs. It is not anticipated that regulatory guidance will be needed to implement the provision. Accelerating the 100-percent deduction may simplify the preparation of tax returns for self-employed individuals, because they will no longer need to keep track of the percent of health insurance expenses that are deductible, and will need to perform one less calculation.

6. Repeal of the temporary federal unemployment "FUTA" surtax (sec. 803 of the conference agreement)

Summary description of provision

Under present law, in addition to the regular FUTA tax of 0.6 percent of taxable wages, a temporary surtax of 0.2 percent of taxable wages applies through 2007. The provision repeals the temporary FUTA surtax (of 0.2 percent of taxable wages) after December 31, 2004.

Number of affected taxpayers

It is estimated that the repeal of the FUTA surtax will affect over six million small businesses.

Discussion

It is not anticipated that small businesses will need to keep additional records due to this provision, nor is it anticipated that this provision will result in an increase in disputes with the IRS. Additional regulatory guidance should not be necessary to implement this provision. The provision should not increase the tax preparation cost of small businesses using a tax preparation service.

7. Increase deduction for business meals (sec. 804 of the conference agreement)

Summary description of provision

The provision phases in an increase in the deductible percentage of business meal (food and beverage) expenses. The increase in the deductible percentage is phased in as follows: 55 percent in 2006; and 60 percent in 2007 and thereafter.

Number of affected taxpayers

It is estimated that almost all small businesses will be affected by the provision.

Discussion

Because the provision increases the percentage deduction only with respect to meals and not entertainment, small businesses may have to keep additional records to distinguish between the two types of expenditures. The provision may lead to additional disputes between small businesses and the IRS regarding the nature of an expenditure, particularly in business situations where the meal and entertainment is provided as a package for a single price. No new regulatory changes would be needed to implement the provision (although a conforming change to regulations to reflect the increasing percentage would be appropriate). The provision may in-

crease complexity because the percentage of the deduction is phased in.

8. Sunset the provisions of the act (sec. 1602 of the conference agreement)

Summary description of provision

The provision sunsets the provisions and amendments made by this Act on the close of September 30, 2009. Certain enumerated provisions of the bill sunset on December 31, 2008.

Number of affected taxpayers

It is estimated that the provision would affect almost all individuals and small businesses.

Discussion

The provision will result in additional complexity and record keeping requirements for individuals and small businesses. Additional forms will be necessary to the extent the sunset causes a provision that had been eliminated to once again become effective. Similarly, additional regulatory guidance may be necessary to provide rules regarding transition issues that may arise as a result of this provision. The provision also can be expected to result in an increase in the tax preparation cost of individuals and small businesses using a tax preparation service.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, August 4, 1999.

Ms. LINDY L. PAULL,
Chief of Staff, Joint Committee on Taxation,
Washington, DC.

DEAR MS. PAULL: Attached are the Internal Revenue Service's comments on the eight provisions of the conference agreement to H.R. 2488 that you identified for complexity analysis in your letter of August 4, 1999. We have reiterated your description of those provisions in the attachment to this letter. Our comments are based on the information provided in the attachment to your letter, as well as language from the House and Senate versions of the bill.

Due to the short turnaround time, and the fact that we did not have the exact language of the conference report, our comments are provisional and subject to change upon a more complete and in-depth analysis of the provisions.

Sincerely,

CHARLES O. ROSSOTTI,
Commissioner.

Attachment.

COMPLEXITY ANALYSIS OF PROVISIONS FROM CONFERENCE AGREEMENT ON H.R. 2488

RATE REDUCTION

Provision: A reduction in the individual regular income tax rates as follows: (1) from 15 percent to 14 percent; (2) from 28 percent to 27 percent; (3) from 31 percent to 30 percent; (4) from 36

percent to 35 percent; and (5) from 39.6 percent to 38.6 percent. The reduction of the 15-percent rate to a 14-percent rate is phased-in over three years: (1) 14.5 percent in 2001 and 2002; and (2) 14 percent in 2003 and thereafter. The reductions in the other rates are effective for taxable years beginning after 2004. The provision also widens the lowest regular income tax bracket for singles and heads of household by $3,000 for taxable years beginning after 2005. For years after 2006, the $3,000 amount is indexed for inflation.

IRS Comments: The tax rate changes and the increase in the width of the 14 percent bracket mandated by the provision would be incorporated in the tax tables and tax rate schedules during IRS' annual update of these items. Changes would be required to the tax tables and tax rate schedules shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR–EZ, and 1041, and on Forms 1040–ES, W–4V, and 8814 for 2001, 2003, 2005, and later years. Other forms (e.g., Form 8752) would also be affected. No new forms would be required. Programming changes would be required to reflect the new rates and wider 14 percent rate bracket.

MARRIAGE PENALTY RELIEF

Provision: An increase in the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual. This increase is phased-in over five years (2001–2005) and is fully effective in 2005. The provision also increases the size of the lowest regular income tax rate bracket to twice the size of the rate bracket for an unmarried individual. This increase in the rate bracket is phased-in over four years (2005–2008) and is fully effective in 2008.

IRS Comments: The increase in the basic standard deduction for married taxpayers filing jointly would be incorporated in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, and 1040NR–EZ, and on Forms 1040, 1040A, 1040EZ, and 1040–ES for each year during the phase-in period (2001–2005). The increase in the width of the 14 percent bracket would be incorporated in the tax tables and tax rate schedules in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, and 1040NR–EZ for each year during the phase-in period (2005–2008). No new forms would be required. Programming changes would be required to reflect the increased standard deduction and wider 14 percent rate bracket for married taxpayers filing jointly.

REDUCED CAPITAL GAINS RATE AND INDEXING

Provision: A reduction of the individual capital gain rates of 10, 20, and 25 percent to 8, 18, and 23 percent, respectively, effective for transactions on or after January 1, 1999. The provision also provides for the indexation of capital gains beginning in 2000 (with mark-to-market treatment with respect to assets held on January 1, 2000).

IRS Comments: The provision would require revision of the following 1999 forms to reflect the reduced capital gains tax rates: Schedule D (Form 1040). Schedule D (Form 1041), Form 6251, and Schedule I of Form 1041. No additional lines or worksheets would be necessary, provided that section 1(h)(13)(C) of the Code, relating

to special rules for pass-through entities, is repealed. No new forms would be required. Programming changes would be required to reflect the new rates. Programming changes would be required to reflect the reduced capital gain rates.

The indexing provision would result in an increase in taxpayer burden. The IRS would need to develop a 6-column worksheet and a table of indexing factors beginning with the 2000 (or 2001) instructions for Schedules D of Forms 1040, 1041, 1065, 1065–B, and 1120–S, to help taxpayers figure the increase in the basis of each asset they sell. Indexing would be especially burdensome for taxpayers who have dividend reinvestment plans or who periodically add small amounts to their mutual funds. Each dividend reinvestment and/or periodic addition would be viewed as a separate asset purchase that would have to be indexed based on when the reinvestment or addition was made. Most capital improvements would be similarly treated as separate asset acquisitions. Assuming corporations are ineligible for indexing, the provision would also require two separate basis calculations for assets held by partnerships that have corporate partners. No new forms or programming changes would be required.

Indexing would lead to increased taxpayer error. Errors detected on the face of the return during processing would be sent to Error Resolution for correction, which would result in additional taxpayer contacts as well as delays in issuing refunds. Such errors would increase the IRS' processing costs. Most indexing errors would only be detectable through an examination of the return.

Taxpayers would have to maintain proof (i.e., a copy of their return) of their mark-to-market election well into the future in order to establish their asset basis. Failure to maintain this proof could lead to disputes with the IRS when the asset is eventually sold or disposed of.

Complications from indexing would likely cause an increase in the number of taxpayers who use a paid preparer and discourage the use by taxpayers of the electronic On-Line Filing program. The indexing and the mark-to-market provisions would result in increased taxpayer inquiries over the toll-free telephone lines, which might be beyond the capacity of the IRS to handle.

INCREASED IRA CONTRIBUTION LIMITS

Provision: An increase in the $2,000 IRA contribution limit to $3,000 for 2001–03, to $4,000 in 2004–05, and to $5,000 in 2006–08.

IRS Comments: This provision would require a change to the dollar limit specified in the Form 1040, Form 1040A, Form 8606, and Form 5329 instructions for 2001, 2004, and 2006. The change would also be reflected in the Form 1040–ES for all applicable years. No new forms or additional lines would be required. Programming changes would be needed to reflect the increased contribution limits.

IRS would need to provide guidance to financial institutions that sponsor IRAs on how to take into account the higher contribution limits (currently all sponsors utilize IRS approved documents). In addition, the following model IRA and Roth IRA documents that

are issued by the Assistant Commissioner (EPEO) would need to be modified to take into account the increased contribution limits:

Form 5305, Individual Retirement Trust Account

Form 5305–A, Individual Retirement Custodial Account

Form 5305–R, Roth Individual Retirement Account

Form 5305–RA, Roth individual Retirement Custodial Account

Form 5305–RB, Roth Individual Retirement Annuity Endorsement

Increase Health Insurance Deduction for Self-Employed to 100 Percent.

Provision: An acceleration of the increase in the deduction of health insurance expenses of self-employed individuals so that the deduction is 100 percent in years beginning after December 31, 1999.

IRS Comments: This provision would enable IRS to eliminate one line from the self-employed health insurance deduction worksheet contained in the 2000 instructions for Forms 1040 and 1040NR. This worksheet is currently four lines. The Form 1040–ES for 2000 would also reflect the provision. No new forms would be required.

REPEAL FUTA SURTAX AFTER DECEMBER 31, 2004

Provision: A repeal of the temporary FUTA surtax (0.2 percent of wages) after December 31, 2004.

IRS Comments: The provision would require a change to the FUTA tax rate on forms 940, 940–EZ, 940–PR and Schedule H of Form 1040 for 2005. The rate would be reduced from 6.2 percent to 6.0 percent. No new forms would be required. Programming changes would be necessary to reflect the reduced FUTA rate.

RESTORATION OF 80 PERCENT DEDUCTION FOR MEAL EXPENSES

Provision: An increase from 50 percent to 80 percent in the deductible percentage of business meal (food and beverage) expenses. The increase in the deductible percentage is phased-in according to the following schedule: 55 percent in 2005; 60 percent in 2006; 65 percent in 2007; 70 percent in 2008; 75 percent in 2009; and 80 percent in 2010 and thereafter.

IRS Comments: This provision would require the addition of a new 5-line column on Form 2106 and a new line on form 2106–EZ to account for the different limits on meal expenses and entertainment expenses. Currently, the same 50 percent limit generally applies both types of expenses. Minor changes to the instructions for Schedules, C, C–EZ, E, and F of Form 1040; Form 1065; and the Form 1120 series would also be required. No new forms would be required.

SUNSET

Provision: A sunset of all the provisions in the Act, as of the close of September 30, 2009.

IRS Comments: Sunsetting all of the Act provisions at the same time would result in massive changes to tax forms and instructions (and related programming) for the sunset year. For taxpayers, the changes would be both burdensome and confusing. The

"mid-year" sunset (i.e., September 30 as opposed to December 31) would greatly complicate matters and exacerbate the burden and confusion for taxpayers.

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 2488

Fiscal Years 2000 - 2009

[Millions of Dollars]

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
I. Broad-Based and Family Tax Relief Provisions													
A. Reduction in Individual Income Taxes - 15% rate reduced to 14.5% in 2001 and 2002, 14% in 2003 and thereafter; all other rates including AMT reduced by 1 percentage point in 2005; increase 14% bracket width for non-joint returns by $3,000 in 2006; sunset after 2008	tyba 12/31/00	---	-7,927	-11,585	-20,207	-25,176	-37,718	-50,819	-54,740	-57,297	-17,105	-64,895	-282,574
B. Family Tax Relief													
1. Elimination of marriage penalty in standard deduction - standard deduction for joint return set at two times single standard deduction, phased in over 5 years; increase width of 14% bracket to 2 times the single bracket, phased in over 4 years beginning in 2005, sunset after 2008	tyba 12/31/00	---	-748	-1,841	-2,827	-3,921	-8,163	-17,724	-22,076	-27,563	-28,018	-9,337	-112,881
2. Marriage Penalty Relief Relating to the Earned Income Credit - increase the income starting and ending point for the earned income credit for married couples filing joint returns by $2,000 indexed after 2006 (phaseout rate stays the same)	tyba 12/31/05	---	---	---	---	---	---	-263	-1,315	-1,302	-1,283	---	-4,163
3. Tax exclusion for certain foster care payments	tyba 12/31/99	-6	-14	-21	-29	-37	-44	-52	-61	-70	-80	-108	-414
4. Expansion of adoption credit - for special needs adoption only, eliminate expense requirement and allow a $10,000 tax credit for special needs adoptions beginning in 2001	tyba 12/31/00	---	-8	-28	-30	-33	-36	-39	-41	-42	-43	-99	-300
5. Increase the dependent care tax credit - increase percentage to 35% for AGI under $30,000; increase percentage to 40% in 2006; index maximum expense limits for inflation; percentage phases down in 1% increments, but not below 20%, for each $1,000 of AGI over $30,000; expand allowable expenses to $200 per month for all children under age 1 beginning in 2006	tyba 12/31/01	---	---	-71	-291	-313	-328	-541	-1,135	-1,093	-1,134	-675	-4,907

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
C. Repeal of Alternative Minimum Tax on Individuals - make permanent the present-law provision to allow nonrefundable personal credits against the individual AMT, effective for 1999 and thereafter; repeal 90% limit on foreign tax credits effective for taxable years beginning after 12/31/01; phaseout the individual AMT by paying the following percent of AMT liability: 80% in 2005, 70% in 2006, 60% in 2007, repeal in 2008; unused AMT credit carryovers as of repeal may be used to offset 90% of regular tax (repeal eliminates AMT marriage penalty); sunset after 2008	tyba 12/31/98	-980	-1,028	-1,529	-2,190	-3,465	-5,369	-9,081	-15,098	-30,835	-33,275	-9,192	-102,850
Total of Broad-Based and Family Tax Relief Provisions		**-986**	**-9,725**	**-15,075**	**-25,574**	**-32,945**	**-51,658**	**-78,519**	**-94,466**	**-118,202**	**-80,938**	**-84,304**	**-508,089**
II. Savings and Investment Tax Relief Provisions													
A. Capital Gains Tax Relief													
1. Reduce long-term capital gains rates from 20% and 10% to 18% and 8%; reduce the rate at which section 1250 deductions are recaptured from 25% to 23%; indexing for assets purchased after, and for inflation occurring after 12/31/99; on 1/1/00, mark-to-market assets purchased before 2000 to qualify for indexing; sunset the rate reductions and indexing on 12/31/08	da 12/31/98	-1,233	15,505	-4,318	-5,874	-6,517	-7,129	-7,759	-8,091	-7,578	517	-2,437	-32,477
2. Reduce tax on capital gains of designated settlement funds to individual capital gains rates under the bill	tyba 12/31/99	-12	-59	-67	-75	-85	-96	-110	-123	-137	-153	-298	-917
3. Suspend 5-year holding period requirement 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 residence is located	sa DOE	-5	-12	-13	-13	-14	-14	-15	-15	-16	-16	-57	-133
4. Suspend 5-year holding period requirement (for a maximum of 5 years) relating to gain on sale of principal residence by employee who is sent out of the United States by an employer	sa DOE	-18	-26	-28	-29	-30	-31	-32	-33	-34	-35	-131	-296
5. Clarify the tax treatment of income and losses from derivatives	DOE	[1]	1	1	1	1	1	1	1	1	1	4	9
6. Modify treatment of worthless securities of certain financial institutions	sbwi tyba 12/31/99	-8	-12	-12	-11	-11	-10	-10	-10	-10	-10	-58	-108
B. Individual Retirement Arrangements													
1. Set the annual contribution limits for all IRAs to $3,000 for 2001 through 2003, $4,000 for 2004 and 2005, $5,000 for 2006 through 2008, and $2,000 for 2009 and thereafter	tyba 12/31/00	—	-618	-1,324	-1,532	-2,391	-3,335	-4,096	-4,885	-5,347	-3,900	-5,865	-27,429
2. Increase the AGI phaseout ranges for contributions to Roth IRAs to $100,000 - $110,000 single, $200,000 - $210,000 joint	tyba 12/31/02	—	—	—	-8	-53	-139	-244	-359	-502	-655	-61	-1,960

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
3. Increase the income limit for conversions of an IRA to a Roth IRA to $200,000 for joint filers	tyba 12/31/02	---	---	---	461	1,172	458	-611	-981	-601	-198	1,634	-299
4. Employers permitted to establish a separate IRA fund in their tax-qualified plan to accept IRA contributions from employees	tyba 12/31/99	*Negligible Revenue Effect*											
5. Increase in maximum contribution limits for IRAs for individuals age 50 and above by 10% annually beginning in 2001, not to exceed 50%; sunset 12/31/08	yba 12/31/00	---	-74	-228	-408	-518	-539	-564	-537	-493	-334	-1,227	-3,694
Total of Savings and Investment Tax Relief Provisions		**-1,276**	**14,705**	**-5,989**	**-7,488**	**-8,446**	**-10,834**	**-13,440**	**-15,033**	**-14,717**	**-4,783**	**-8,496**	**-67,304**
III. Alternative Minimum Tax Reform Provision													
1. Corporate AMT - repeal 90% limit on foreign tax credit and net operating losses effective for taxable years beginning after 12/31/01; allow any AMT credit carryover to reduce minimum tax by 50% but not below regular tax for taxable years beginning after 12/31/04	generally tyba 12/31/04	---	---	-403	-774	-620	-1,193	-1,443	-1,299	-1,169	-1,052	-1,797	-7,952
Total of Alternative Minimum Tax Reform Provision		**---**	**---**	**-403**	**-774**	**-620**	**-1,193**	**-1,443**	**-1,299**	**-1,169**	**-1,052**	**-1,797**	**-7,952**
IV. Education Savings Incentive Provisions													
1. Education savings accounts (formerly "Education IRAs") - increase the annual contribution limit to $2,000; expand the definition of qualified education expenses to include elementary and secondary education expenses (and after-school programs); allow ESAs to be used for special needs beneficiaries; allow corporations and other entities to contribute to ESAs; allow contributions until April 15 of following year; and allow taxpayer to exclude ESA distribution from gross income and claim HOPE or Lifetime Learning credit as long as they are not used for same expenses	tyba 12/31/00	---	-46	-152	-230	-311	-394	-475	-566	-651	-726	-739	-3,552
2. Prepaid Savings Plans - State-sponsored plans: exclusions for distributions for education expenses, beginning in 2000; private plans: tax deferral on income beginning in 2000; exclusion for distributions for education expenses beginning in 2004; allow tax-free education withdrawals from prepaid savings plans as long as they are not used for the same expenses for which HOPE or Lifetime Learning credits are claimed, beginning in 2000; miscellaneous other changes (clarify definition; one rollover per year)	tyba 12/31/99	-6	-21	-35	-54	-78	-110	-144	-178	-210	-244	-195	-1,081

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
3. Exclude from tax awards under the following programs: National Health Corps Scholarship program, beginning in 1994; F. Edward Hebert Armed Forces Health Professions Scholarship program, beginning in 1994; National Institutes of Health Undergraduate Scholarship Program, beginning in 1994; and similar State-sponsored scholarship programs, beginning in 2000;	tyba 12/31/93 & tyba 12/31/99	-3	-3	-3	-3	-3	-4	-4	-4	-4	-5	-16	-36
4. Extension of employer provided educational assistance - extend the exclusion for undergraduate courses through 2003 [2]	1/1/00	-134	-318	-394	-421	-151	---	---	---	---	---	-1,419	-1,419
5. Provide new 4-year expenditure schedule for bonds for public school construction under the arbitrage rebate rules	bia 12/31/99	-13	-120	-236	-274	-292	-307	-310	-305	-300	-293	-935	-2,450
6. Increase the school construction small issuer arbitrage rebate exception from $10 million to $15 million	bia 12/31/99	[3]	-2	-4	-5	-13	-14	-14	-15	-16	-17	-25	-102
7. Increase student loan deduction income limits for single taxpayers by $5,000 and adjust the income limits for married couples filing joint returns to twice that of a single taxpayer; phase-out range of $15,000 for both; repeal 60-month rule	tyea 12/31/99	-46	-193	-223	-253	-288	-295	-305	-315	-325	-337	-1,004	-2,582
8. 2% floor on miscellaneous itemized deductions not to apply to qualified professional development expenses; with $1,000 cap	tyba 12/31/00	---	-5	-10	-10	-10	-5	---	---	---	---	-35	-40
Total of Education Savings Incentive Provisions		**-202**	**-708**	**-1,057**	**-1,250**	**-1,146**	**-1,129**	**-1,252**	**-1,383**	**-1,506**	**-1,622**	**-4,368**	**-11,262**
V. Health Care Provisions													
1. Provide an above-the-line deduction for health insurance expenses - 25% in 2002 through 2004, 35% in 2005, 65% in 2006, and 100% thereafter	tyba 12/31/01	---	---	-444	-1,379	-1,477	-1,803	-3,137	-5,878	-8,299	-8,848	-3,300	-31,264
2. Provide an above-the-line deduction for long-term care insurance expenses - 25% in 2002 through 2004, 35% in 2005, 65% in 2006, and 100% thereafter	tyba 12/31/01	---	---	-48	-328	-364	-417	-677	-1,315	-2,027	-2,146	-741	-7,323
3. Allow long-term care insurance to be offered as part of cafeteria plans; limited to amount of deductible premiums [4]	tyba 12/31/01	---	---	-104	-151	-171	-190	-202	-204	-215	-247	-426	-1,484
4. Provide an additional dependency deduction to caretakers of elderly family members	tyba 12/31/99	-180	-276	-275	-283	-304	-324	-350	-394	-418	-428	-1,317	-3,231
5. Increase the time period for measuring eligible expenses qualifying for the orphan drug tax credit	eia 12/31/99	-5	-8	-9	-10	-10	-11	-12	-13	-14	-15	-42	-107
6. Add certain vaccines against Streptococcus Pneumoniae to the list of taxable vaccines in the Federal vaccine insurance program; study of Federal vaccine insurance program; reduce excise tax on all taxable vaccines to $0.50 per dose beginning in 2005	[5] & tyba 12/31/04	4	7	9	10	10	-26	-38	-38	-39	-39	39	-141

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
7. Itemized deduction for certain nonprescription drug expenses of Medicare enrollees, and above-the-line deduction for prescription drug insurance coverage of Medicare beneficiaries if certain Medicare and low-income assistance provisions in effect	tyba 12/31/02	---	---	---	-6	-38	-42	-47	-53	-60	-68	-43	-314
Total of Health Care Provisions		**-181**	**-277**	**-871**	**-2,147**	**-2,354**	**-2,813**	**-4,463**	**-7,895**	**-11,072**	**-11,791**	**-5,830**	**-43,864**
VI. Estate and Gift Tax Relief Provisions													
1. Phase in repeal of estate, gift, and generation-skipping transfer taxes: beginning in 2001, convert the unified credit into a true exemption, repeal the 5% "bubble" (which phases out the lower rates); repeal rates in excess of 53%; in 2002, repeal rates in excess of 50%; in 2003 through 2006, reduce all rates by 1 percentage point a year; in 2007, reduce all rates by 1.5 percentage points; in 2008, reduce all rates by 2 percentage points; proportionately reduce State tax credit rates; beginning in 2009, repeal all of these taxes; carryover basis applies to transfers by gift or by death after 12/31/08 for estates with total assets of fair market value of $2 million or less and spouse transfers of $3 million or less	dda & gma 12/31/00	---	---	-4,166	-5,612	-6,379	-7,403	-8,431	-9,540	-10,902	-12,889	-16,157	-65,322
2. Provide deemed allocation of GST exemption	ta DOE	[3]	-1	-3	-4	-4	-4	-4	-4	-4	-4	-12	-32
3. Provide retroactive allocation of GST for unnatural orders of death	generally DOE	-3	-4	-5	-6	-6	-6	-6	-6	-6	-6	-24	-54
4. Allow severances of trusts holding property having an inclusion ratio of greater than zero	---	*Included in Estate and Gift Item 3.*											
5. Modify certain valuation rates	---	*Included in Estate and Gift Item 3.*											
6. Provide relief from late elections	---	*Included in Estate and Gift Item 3.*											
7. Provide rule of substantial compliance	---	*Included in Estate and Gift Item 3.*											
8. Expand estate tax rule for conservation easements - increase the 25-mile limit to 50 miles; increase 10-mile limit to 25 miles, and clarify that the date for determining easement compliance	dda 12/31/99 & dda 12/31/97	---	-10	-13	-19	-20	-20	-21	-22	-24	-26	-62	-175
Total of Estate and Gift Tax Relief Provisions		**-3**	**-15**	**-4,187**	**-5,641**	**-6,409**	**-7,433**	**-8,462**	**-9,572**	**-10,936**	**-12,925**	**-16,255**	**-65,583**
VII. Distressed Communities and Industries Provisions													
A. American Community Renewal Act of 1999													
1. Designate 20 renewal communities; provide various incentives (zero capital gains tax on certain 5-year investments; special deduction for real estate revitalization expenditures; special expensing for certain business property; work opportunity tax credit; remediation expenses; family development accounts) beginning 1/1/01 and ending 12/31/07 [6]	DOE	---	-129	-252	-288	-293	-305	-333	-424	-107	-18	-963	-2,151

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
B. Farming Incentive													
1. Provide that Federal farm production payments are taxable in the year of receipt (ignore election to take the payments in an earlier year unless exercised)	DOE	*Negligible Revenue Effect*											
C. Oil and Gas Incentives													
1. Allow 5-year carryback of oil and gas net operating losses	lii tyba 12/31/98	-46	-28	-24	-21	-20	-20	-21	-21	-22	-23	-139	-246
2. Allow delay rental payments to be deducted currently	tyba 12/31/99	-3	-4	-4	-4	-4	-4	-4	-3	-4	-5	-19	-39
3. Allow geological and geophysical costs to be deducted currently	tyba 12/31/99	-18	-25	-26	-27	-27	-28	-29	-29	-30	-31	-121	-267
4. Suspend the 65% of taxable income limit on percentage depletion for 6 years	tyba 12/31/98 & tybb 1/1/05	-10	-12	-15	-17	-20	-10	---	---	---	---	-74	-84
5. Modify the refining threshold in section 613(d)(4) from "on any given day" to average production	tyba 12/31/99	-1	-2	-2	-2	-2	-2	-2	-2	-2	-2	-9	-19
D. Timber Incentives													
1. Increase maximum reforestation expenses qualifying for amortization and credit from $10,000 to $25,000; remove cap on amortization of reforestation costs in 2000 through 2003	epoii tyba 12/31/99	-5	-15	-22	-29	-34	-36	-38	-37	-33	-29	-104	-277
2. Section 631(b) treatment of sales of timber	sa DOE	*Negligible Revenue Effect*											
Total of Distressed Communities and Industries Provisions		**-81**	**-215**	**-345**	**-388**	**-400**	**-405**	**-427**	**-516**	**-198**	**-108**	**-1,429**	**-3,083**
VIII. Small Business Tax Relief Provisions													
1. Accelerate 100% self-employed health insurance deduction; extend eligibility for self-employed health insurance deduction to those who choose not to participate in employer-subsidized health plans	tyba 12/31/99	-245	-1,007	-1,040	-657	---	---	---	---	---	---	-2,949	-2,949
2. Increase section 179 expensing to $30,000	tyba 12/31/99	-790	-880	-189	-95	2	-31	-90	-142	-157	-160	-1,954	-2,533
3. Accelerate repeal of the FUTA surtax	lpo/a 1/1/05	---	---	---	---	---	-1,029	-421	-21	1,058	413	---	---
4. Business meals deduction provisions:													
a. Increase business meals deduction (excluding entertainment expenses) by 5 percentage points per year beginning in 2006 until it reaches 60%	tyba 12/31/05	---	---	---	---	---	---	-307	-940	-1,286	-1,334	---	-3,867
b. Accelerate the 80% meals deduction for persons subject to the hours of service requirements by 1 year	DOE	---	---	---	---	---	---	---	-13	-13	---	---	-26
5. Coordinate farmer income averaging and the AMT and provide the same income averaging relief to commercial fishermen	tyba 12/31/99	[3]	-1	-1	-1	-2	-3	-3	-4	-5	-6	-8	-27
6. Create new Farm, Fish, and Ranch Risk Management ("FFARRM") Accounts	tyba 12/31/00	---	-7	-150	-208	-177	-145	-112	-49	-23	-23	-542	-895
7. Exclude investment securities income from passive income test	tyba 12/31/99	-2	-2	-2	-2	-2	-2	-2	-3	-3	-3	-10	-23
8. Treatment of qualifying director shares	tyba 12/31/99	-1	-3	-5	-7	-9	-11	-13	-15	-17	-18	-26	-100
Total of Small Business Tax Relief Provisions		**-1,038**	**-1,900**	**-1,387**	**-970**	**-188**	**-1,221**	**-948**	**-1,187**	**-446**	**-1,131**	**-5,489**	**-10,420**

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
IX. International Tax Relief Provisions													
1. Allocate interest expense on worldwide basis	tyba 12/31/01	---	---	-825	-2,641	-2,839	-3,052	-3,281	-3,527	-3,792	-4,076	-6,305	-24,033
2. Simplify and apply look-through treatment for dividends of 10/50 companies and for separate basket excess credit carryovers	tyba 12/31/01	---	---	-116	-451	-172	-63	-32	-22	-17	-12	-739	-885
3. Exception from subpart F treatment for certain pipeline transportation and electricity transmission income	tyba 12/31/01	---	---	-3	-10	-13	-15	-17	-20	-23	-25	-26	-126
4. Recharacterize overall domestic loss	tyba 12/31/05	---	---	---	---	---	---	-223	-471	-494	-529	---	-1,717
5. Repeal limitation on foreign sales corporation tax benefits for defense products	tyba 12/31/01	---	---	-45	-108	-121	-136	-153	-173	-194	-215	-274	-1,145
6. Treatment of regulated investment companies	mf tyba 12/31/04	---	---	---	---	---	-82	-153	-162	-171	-182	---	-750
7. Repeal special foreign tax credit rules for foreign oil and gas income	tyba 12/31/07	---	---	---	---	---	---	---	---	-418	-1,259	---	-1,677
8. Prohibit disclosure of advance pricing agreements (APAs) and related information; require the IRS to submit to Congress an annual report of such agreements; APA user fee	DOE	*Negligible Revenue Effect*											
9. Increase the section 911 exclusion by $3,000 per year starting in 2003 until it reaches $95,000; index for inflation in 2008, for inflation occurring after 2006	1/1/03	---	---	---	-24	-48	-80	-107	-131	-155	-184	-72	-729
10. Exempt from the 7.5% air passenger ticket tax frequent flier miles to persons with foreign addresses	raa 12/31/04	---	---	---	---	---	-34	-29	-29	-30	-32	---	-155
Total of International Tax Relief Provisions		**---**	**---**	**-989**	**-3,234**	**-3,193**	**-3,462**	**-3,995**	**-4,535**	**-5,294**	**-6,514**	**-7,416**	**-31,217**
X. Tax-Exempt Organization Provisions													
1. Provide a tax exemption for organizations created by a State to provide property and casualty insurance coverage for property for which such coverage is otherwise unavailable	tyba 12/31/99	-2	-4	-4	-4	-5	-5	-6	-7	-8	-8	-18	-53
2. Modify special provision for a permanent university fund	tyba 12/31/99	[3]	-1	-1	[3]	[3]	[1]	[3]	-1	[3]	[3]	-2	-3
3. Authorize the Secretary of the Treasury to grant waivers from section 4941 self-dealing prohibitions	DOE	*Negligible Revenue Effect*											
4. Extend declaratory judgement remedy to certain organizations seeking determinations of tax-exempt status	DOE	*Negligible Revenue Effect*											
5. Modify section 512(b)(13) to exempt income received by a tax-exempt organization from certain subsidiaries when fair market value pricing is used, excess of fair market value subject to UBIT and 20% penalty tax, and extension of transition relief for certain binding contracts	DOE & proaa 12/31/99	-7	-9	-11	-11	-11	-11	-12	-12	-12	-13	-49	-110
6. Tax exclusion for mileage reimbursements by public charities not in excess of standard business mileage rate	tyba 12/31/99	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1	-2

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
7. Charitable deduction for certain expenses in support of Native Alaskan subsistence whaling	tyba 12/31/99	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1	-3
8. Simplify lobbying expenditure limitations	tyba 12/31/99	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1
9. Tax-Free withdrawals from IRAs for charitable donations to charitable organizations after age 70.5	tyba 12/31/02	---	---	---	-172	-240	-229	-231	-233	-235	-238	-412	-1,578
Total of Tax-Exempt Organization Provisions		**-9**	**-14**	**-16**	**-187**	**-256**	**-245**	**-249**	**-253**	**-255**	**-259**	**-483**	**-1,750**
XI. Real Estate Tax Relief Provisions													
A. Improvements in the Low-Income Housing Credit													
1. Low-income housing tax credit - increase per capita credit by $0.10 per year through 2004; thereafter COLA; $2 million small State minimum beginning in 2000; COLA beginning in 2005; modify stacking rules and credit allocation rules; certain Native American housing assistance disregarded in determining whether building is Federally subsidized for purposes of the low-income housing credit	tyba 12/31/99	-5	-26	-75	-152	-258	-391	-545	-713	-893	-1,087	-515	-4,145
B. Real Estate Investment Trust (REIT) Provisions													
1. Impose 10% vote or value test	tyba 12/31/00	---	2	8	8	8	9	9	9	10	10	26	73
2. Treatment of income and services provided by taxable REIT subsidiaries	tyba 12/31/00	---	60	158	53	23	-9	-45	-84	-127	-173	294	-145
3. Personal property treatment for determining rents from real property for REITs	tyba 12/31/00	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-3	-7
4. Special foreclosure rule for health care REITs	tyba 12/31/00	*Negligible Revenue Effect*											
5. Conformity with RIC 90% distribution rules	tyba 12/31/00	---	1	1	1	1	1	1	1	1	1	3	5
6. Clarification of definition of independent operators for REITs	tyba 12/31/00	*Negligible Revenue Effect*											
7. Modification of earnings and profits rules	da 12/31/00	---	-6	-3	-3	-3	-4	-4	-4	-4	-4	-16	-35
C. Modify At-Risk Rules for Publicly Traded Securities	dlia 12/31/99	[3]	-2	-4	-5	-6	-8	-10	-12	-14	-16	-19	-78
D. Treatment of Certain Contributions to Capital of Retailers - amend section 118 to clarify the tax treatment of certain construction allowances or contributions received by retail operators	ara 12/31/99	-1	-2	-6	-10	-14	-18	-22	-27	-31	-36	-32	-166
E. Accelerate 5-year phase in of private activity bond volume cap	bia 12/31/99	-4	-27	-73	-133	-193	-240	-265	-264	-248	-228	-430	-1,675
D. Deduction for Renovating Historic Homes - miscellaneous itemized deduction for 50% of cost for renovating owner-occupied historic homes up to maximum of $50,000; adjustment to basis	eia 12/31/99	-28	-110	-114	-116	-118	-120	-122	-124	-142	-148	-486	-1,142
Total of Real Estate Tax Relief Provisions		**-38**	**-111**	**-109**	**-358**	**-561**	**-781**	**-1,004**	**-1,219**	**-1,449**	**-1,682**	**-1,178**	**-7,315**
XII. Pension Reform Provisions													
A. Provisions for Expanding Coverage													
1. Increase contribution and benefit limits:													
a. Increase limitation on exclusion for elective deferrals to $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, $15,000 in 2005; index in $500 increments thereafter [7] [8]	yba 12/31/00	---	-131	-315	-465	-561	-638	-694	-741	-788	-835	-1,472	-5,168

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
b. Increase limitation on SIMPLE elective contributions to $7,000 in 2001, $8,000 in 2002, $9,000 in 2003, $10,000 in 2004; index in $500 increments thereafter [7] [8]	yba 12/31/00	---	-5	-14	-22	-27	-29	-29	-30	-32	-33	-67	-220
c. Increase defined benefit dollar limit to $160,000	yba 12/31/00	---	-18	-31	-40	-45	-48	-50	-53	-55	-57	-134	-396
d. Lower early retirement age to 62; lower normal retirement age to 65	yba 12/31/00	---	-3	-4	-4	-4	-5	-5	-5	-5	-5	-16	-40
e. Increase annual addition limitation for defined contribution plans to $40,000 [7]	yba 12/31/00	---	-6	-11	-13	-14	-15	-16	-16	-17	-18	-44	-125
f. Increase qualified plan compensation limit to $200,000 [7]	yba 12/31/00	---	-40	-69	-78	-83	-89	-95	-101	-107	-113	-270	-776
g. Increase limits on deferrals under deferred compensation plans of State-local governments and tax-exempt organizations to $11,000 in 2001, $12,000 in 2002, $13,000 in 2003, $14,000 in 2004, $15,000 in 2005 [7]	yba 12/31/00	---	-51	-90	-104	-115	-123	-130	-138	-143	-146	-360	-1,039
2. Plan loans for subchapter S owners, partners, and sole proprietors	yba 12/31/00	---	-20	-30	-32	-35	-37	-39	-41	-44	-46	-117	-325
3. Modification of top-heavy rules	pyba 12/31/00	---	-4	-9	-11	-12	-14	-16	-17	-19	-21	-36	-123
4. Elective deferrals not taken into account for purposes of deduction limits	yba 12/31/00	---	-38	-71	-81	-85	-89	-93	-97	-101	-104	-275	-759
5. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations	yba 12/31/00	---	-16	-22	-22	-22	-22	-23	-24	-25	-26	-82	-202
6. Elimination of user fee for certain requests regarding employer pension plans; waiver applies only for request made during first 5 plan years [9]	rma 12/31/00	---	-9	-5	-5	-5	-5	-5	-6	-6	-6	-24	-52
7. Definition of compensation for purposes of deduction limits [7]	yba 12/31/00	---	-1	-2	-3	-3	-3	-3	-3	-3	-3	-9	-24
8. Option to treat elective deferrals as after-tax contributions	tyba 12/31/00	---	50	100	131	144	89	-2	-104	-218	-345	426	-155
8. Reduce PBGC premium for new plans of small employers [9]	pea 12/31/00	---	---	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	-1	-3
9. Phase-in of additional PBGC premium for new plans; include additional variable premium relief for small employers [9]	pea 12/31/00	---	---	[10]	[10]	[10]	[10]	[10]	[10]	[10]	[10]	-9	-26
Subtotal of Provisions for Expanding Coverage		---	-292	-576	-752	-870	-1,031	-1,203	-1,379	-1,566	-1,761	-2,490	-9,433
B. Provisions for Enhancing Fairness for Women													
1. Additional catch-up contributions for individual age 50 and above - increase in maximum contribution limits for pension plans by 10% annually beginning in 2001, not to exceed 50%; sunset 12/31/08	yba 12/31/00	---	-73	-151	-130	-95	-82	-81	-84	-86	-43	-449	-825
2. Equitable treatment for contributions of employees to defined contribution plans [7]	yba 12/31/00	---	-50	-75	-81	-87	-92	-97	-103	-107	-110	-294	-804
3. Faster vesting of certain employer matching contributions	pyba 12/31/00	*Negligible Revenue Effect*											

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
4. Simplify and update the minimum distribution rules by modifying post-death distribution rules, reducing (to 10%) the excise tax on failures to make minimum distributions, and directing the Treasury to simplify and finalize regulations relating to the minimum distribution rules	yba 12/31/00	---	-118	-212	-239	-268	-297	-330	-366	-402	-441	-837	-2,673
5. Clarification of tax treatment of division of section 457 plan benefits upon divorce	tdapma 12/31/00	*Negligible Revenue Effect*											
6. Modification of safe harbor relief for hardship withdrawals from 401(k) plans	yba 12/31/00	*Negligible Revenue Effect*											
Subtotal of Provisions for Enhancing Fairness for Women		---	-241	-438	-450	-450	-471	-508	-553	-595	-594	-1,580	-4,302
C. Provisions for Increasing Portability for Participants													
1. Rollovers allowed among governmental section 457 plans, section 403(b) plans, and qualified plans	dma 12/31/00	---	-7	-11	-12	-12	-12	-13	-13	-13	-14	-41	-106
2. Rollovers of IRAs to workplace retirement plans	dma 12/31/00	*Negligible Revenue Effect*											
3. Rollovers of after-tax retirement plan contributions	dma 12/31/00	*Negligible Revenue Effect*											
4. Waiver of 60-day rule	dma 12/31/00	*Negligible Revenue Effect*											
5. Treatment of forms of qualified plan distributions	yba 12/31/00	*Negligible Revenue Effect*											
6. Rationalization of restrictions on distributions	da 12/31/00	*Negligible Revenue Effect*											
7. Purchase of service credit in governmental defined benefit plans	ta 12/31/00	*Negligible Revenue Effect*											
8. Employers may disregard rollovers for cash-out amounts	da 12/31/00	*Negligible Revenue Effect*											
Subtotal of Provisions for Increasing Portability for Participants		---	-7	-11	-12	-12	-12	-13	-13	-13	-14	-41	-106
D. Provisions for Strengthening Pension Security and Enforcement													
1. Phase-in repeal of 150% of current liability funding limit; extend maximum deduction rule	yba 12/31/00	---	-7	-21	-33	-36	-36	-38	-38	-39	-41	-98	-290
2. Missing plan participants	[11]	*Negligible Revenue Effect*											
3. Excise tax relief for sound pension funding	yba 12/31/00	---	-2	-3	-3	-3	-3	-3	-3	-3	-3	-11	-26
4. Notice of significant reduction in plan benefit accruals	pateo/a DOE	*Negligible Revenue Effect*											
5. Investment of employee contributions in 401(k) plans	aiii TRA'97	*Negligible Revenue Effect*											
6. Repeal 100% of compensation limit for multiemployer plans	yba 12/31/00	---	-2	-4	-4	-4	-4	-4	-5	-5	-5	-13	-36
Subtotal of Provisions for Strengthening Pension Security and Enforcement		---	-11	-28	-40	-43	-43	-45	-46	-47	-49	-122	-352
E. Provisions for Reducing Regulatory Burdens													
1. Modification of timing of plan valuations	pyba 12/31/00	*Negligible Revenue Effect*											
2. ESOP dividends may be reinvested without loss of dividend deduction	tyba 12/31/00	---	-19	-44	-56	-61	-63	-66	-69	-71	-74	-180	-523
3. Repeal transition rule relating to certain highly compensated employees	pyba 12/31/99	-1	-2	-3	-3	-3	-3	-4	-4	-4	-4	-12	-31
4. Employees of tax-exempt entities [12]	DOE	*Negligible Revenue Effect*											
5. Treatment of employer-provided retirement advice	yba 12/31/00	*Negligible Revenue Effect*											
6. Pension plan reporting simplification [12]	1/1/01	*Negligible Revenue Effect*											

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
7. Improvement to Employee Plans Compliance Resolution System [12]	DOE	*Negligible Revenue Effect*											
8. Rules for substantial owner benefits in terminated plans [9]	noltta 12/31/00	*Negligible Revenue Effect*											
9. Clarification of exclusion for employer-provided transit passes	tyba 12/31/99	-4	-8	-10	-13	-14	-15	-15	-16	-16	-16	-49	-127
10. Repeal of multiple use test	yba 12/31/00	*Considered in Other Provisions*											
11. Flexibility in nondiscrimination and line of business rules [12]	DOE	*Negligible Revenue Effect*											
12. Extension to international organization of moratorium on application of certain nondiscrimination rules applicable to State and local government plans	yba 12/31/00	*Negligible Revenue Effect*											
Subtotal of Provisions for Reducing Regulatory Burdens		-5	-29	-57	-72	-78	-81	-85	-89	-91	-94	-241	-681
F. Provisions relating to plan amendments	DOE	*No Revenue Effect*											
Total of Pension Reform Provisions		**-5**	**-580**	**-1,110**	**-1,326**	**-1,453**	**-1,638**	**-1,854**	**-2,080**	**-2,312**	**-2,512**	**-4,474**	**-14,874**
XIII. Miscellaneous Provisions													
A. Provisions Primarily Affecting Individuals													
1. Treatment of payments to public safety officer survivors	[13]	-1	-2	-2	-2	-2	-2	-1	-1	-1	-1	-8	-15
2. Increase phaseout of the DC first-time homebuyer credit for joint filers to $140,000 - $180,000	po/a DOE	-1	-2	[3]	[3]	[3]	---	---	---	---	---	-3	-3
3. No Federal income tax on amounts and lands received by holocaust victims or their heirs	a/a DOE	-3	-14	-17	-17	-12	[14]	[14]	[14]	[14]	[14]	-63	-64
B. Provisions Primarily Affecting Businesses													
1. Allow income from publicly traded partnerships to be qualifying income for regulated investment companies	mf tyba 12/31/00	---	-4	-9	-13	-17	-20	-23	-25	-28	-30	-43	-170
2. Equalize the tax treatment of oversized "clean fuel" vehicles and electric vehicles	1/1/00	[3]	[3]	[3]	[1]	[1]	[1]	[1]	[1]	[1]	[1]	[3]	[1]
3. Nuclear decommissioning costs: one-time transfer of non-qualified funds, with amortization over remaining useful life beginning in 2002; modify section 468A to eliminate cost of service requirement in determining nuclear decommissioning costs and clarify treatment of funds transfers	generally tyba 12/31/99	-24	-51	-89	-126	-128	-130	-131	-132	-132	-132	-418	-1,075
4. Repeal 5-year limitations relating to life insurance companies filing a consolidated tax return with an affiliated group of nonlife insurance companies effective 2001; and repeal 5-year rule related to applying losses of non-life companies against income of affiliated life insurance companies, effective 2005	tyba 12/31/00 & tyba 12/31/05	---	-42	-85	-86	-88	-90	-151	-213	-217	-219	-301	-1,189
5. Simplify the active trade or business requirement for tax-free split-off	da DOE	-3	-5	-5	-5	-5	-5	-5	-5	-5	-5	-23	-48

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
6. Modify definition of personal holding company and treat all lending or finance businesses of a controlled corporate group as a single corporation	tyba 12/31/99	-4	-10	-17	-24	-27	-28	-28	-28	-29	-30	-82	-227
7. Brownfields environmental remediation expanded to include all sites except Superfund sites	eia 12/31/99	-19	-19	-5	[3]	[1]	1	2	2	3	5	-42	-29
C. Provisions Relating to Excise Taxes													
1. Repeal 0.1 cent per gallon LUST tax on railroads (10/1/99); consolidate Superfund and LUST trust funds; repeal 4.3-cents-per-gallon tax on railroad fuel and inland waterway fuel currently paid into the General Fund (10/1/03)	10/1/99 & 10/1/03	-2	-2	-2	-2	-117	-125	-128	-131	-134	-137	-125	-780
2. Repeal 10% excise tax on fishing tackle boxes; increase transfer of motor boat gasoline revenues to Aquatic Resources Trust Fund by $0.002	30da DOE	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-15	-30
3. Add inserts and outserts to arrow excise tax; reduce excise tax rate on "broadhead" arrow points	fcqb 30da DOE	*Negligible Revenue Effect*											
4. Treat small seaplanes as general aviation for purposes of the aviation excise taxes	tba 12/31/99	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-11
5. Clarify the definition of rural airport to include communities that cannot be reached by road	tyba 12/31/99	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	[3]	-1	-3
D. Other Provisions													
1. Allow a limited number of private highway projects to qualify for tax-exempt-facility bond financing	bla 12/31/99	---	---	-2	-5	-9	-12	-15	-18	-22	-25	-15	-107
2. Exempt from tax distributions from Alaska Native Corporations to Alaska Native Settlement Trusts; distribution of principal to beneficiaries taxed as ordinary income; income earned by the trust treated as under present law	da 12/31/99	[3]	-1	-2	-2	-2	-2	-2	-1	-1	-1	-7	-13
4. Increase the Joint Committee on Taxation refund review threshold from $1 million to $2 million	DOE	*Negligible Revenue Effect*											
E. Tax Court Provisions [9]	DOE	*Negligible Revenue Effect*											
F. Tax credit for clinical testing research expenses attributable to certain qualified academic institutions including teaching hospitals	tyba 12/31/98	-2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-6	-14
L. Allow Farmer Cooperatives to Pay Dividends on Capital Stock Without Reducing Patronage Dividends	tyba DOE	[3]	[3]	-1	-1	-1	-1	-2	-2	-3	-4	-3	-15
Total of Miscellaneous Provisions		**-63**	**-157**	**-241**	**-288**	**-413**	**-419**	**-489**	**-559**	**-574**	**-584**	**-1,160**	**-3,793**
XIV. Extensions Expiring Provisions													
1. Research tax credit, and increase AIC rates by 1 percentage point (through 6/30/04)	[15]	-1,657	-1,853	-2,228	-2,537	-2,238	-1,340	-707	-433	-127	---	-10,510	-13,115
2. Exemption from Subpart F for active financing income (through 12/31/04)	tyba 1999	-187	-827	-992	-1,190	-1,369	-1,156	---	---	---	---	-4,565	-5,721
3. Suspension of 100% net income limitation for marginal properties (through 12/31/04)	tyba 12/31/99	-23	-35	-36	-36	-37	-13	---	---	---	---	-167	-180
4. Work opportunity tax credit (through 12/31/01)	wpoifibwa 6/30/99	-229	-321	-293	-151	-58	-19	-3	---	---	---	-1,053	-1,074
5. Welfare-to-work tax credit (through 12/31/01)	wpoifibwa 6/30/99	-49	-77	-79	-47	-19	-7	-2	---	---	---	-271	-280

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
6. Extend and modify tax credit for electricity produced from wind and closed-loop biomass facilities - credit to include electricity produced from poultry waste (through 6/30/03)	[16]	-9	-25	-42	-57	-63	-65	-66	-68	-70	-70	-195	-534
Total of Extensions of Expiring Provisions		**-2,154**	**-3,138**	**-3,668**	**-4,018**	**-3,784**	**-2,600**	**-778**	**-501**	**-197**	**-70**	**-16,761**	**-20,904**
XV. Revenue Offset Provisions													
1. Information reporting on cancellation of indebtedness by non-bank financial institutions	coda 12/31/99	---	7	7	7	7	7	7	7	7	7	28	63
2. Extension of IRS user fees (through 9/30/09) [9]	9/30/03	---	---	---	---	50	53	56	59	61	64	50	343
3. Impose limitation on pre-funding of certain employee benefits	cpoaa 6/9/99	115	141	147	149	140	129	118	105	90	74	693	1,209
4. Increase to 15% (from 10%) optional withholding rate for nonperiodic payments from deferred compensation plans	dma 12/31/00	---	52	1	1	1	1	1	1	1	1	55	59
5. Modify estimated tax rules for closely-owned REIT dividends	epdo/a 9/15/99	40	1	1	1	1	1	1	1	1	1	45	52
6. Prevent the conversion of ordinary income or short-term capital gains into income eligible for long-term capital gain rates	telo/a 7/12/99	15	45	47	49	51	54	58	62	66	70	207	517
7. Allow employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees (through 9/30/09)	tmi tyba 12/31/00	---	19	38	39	40	41	42	42	43	44	136	348
8. Repeal installment method for most accrual basis taxpayers; adjust pledge rules	iso/a DOE	477	677	406	257	72	8	21	35	48	62	1,889	2,063
9. Limit use of non-accrual experience method of accounting to amounts to be received for the performance of qualified professional services	tyea DOE	77	60	33	28	10	12	14	16	18	20	208	288
10. Deny deduction and impose excise tax with respect to charitable split-dollar life insurance arrangements	[17]	*Negligible Revenue Effect*											
11. Modify treatment of closely-held REITs, with incubator REIT exception; grandfather REIT transaction in progress	tyea 7/14/99	2	5	5	5	6	6	6	6	7	7	23	55
12. Modify anti-abuse rules related to assumption of liabilities; modify to provide that similar rules apply to partnerships	aolo/a 7/15/99	6	11	10	10	9	9	9	9	9	8	46	90
13. Require consistent treatment and provide basis allocation rules for transfers of intangibles in certain nonrecognition transactions	to/a DOE	25	26	28	29	30	32	34	35	37	39	138	315
14. Distributions by a partnership to a corporate partner of stock in another corporation	[18]	4	9	10	10	9	9	9	9	9	8	42	86
15. Prohibited allocation of stock in an ESOP of a subchapter S corporation	[19]	[20]	[20]	[20]	[20]	[20]	[20]	[20]	[20]	[20]	[20]	17	47
Total of Revenue Offset Provisions		**763**	**1,056**	**737**	**589**	**431**	**367**	**382**	**393**	**403**	**411**	**3,577**	**5,535**

Provision	Effective	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2000-04	2000-09
XVI. Tax Technical Correction Provisions		*No Revenue Effect*											
NET TOTAL		-5,273	-1,079	-34,710	-53,054	-61,737	-85,464	-116,941	-140,105	-167,924	-125,560	-155,863	-791,875
ADDENDUM: TAX CUT TARGET		-14,000	-7,800	-53,500	-31,800	-49,200	-62,600	-109,300	-135,800	-150,700	-177,200	-156,300	-791,900

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column:

aiii TRA'97 = as if included in the Taxpayer Relief Act of 1997
aolo/a = assumption of liabilities on or after
ara = amounts received after
bia = bonds issued after
coda = cancellation of indebtedness after
cpoaa = contributions paid or accrued after
da = distributions after
ddia = decedents dying after
diia = debt instruments issued after
dma = distributions made after
DOE = date of enactment
eia = expenses incurred after
epdo/a = estimated payments due on or after
epoii = expenses paid or incurred in
fcqb = first calendar quarter beginning at least
gma = gifts made after
iso/a = installment sales on or after
lii = losses incurred in
lpo/a = labor performed on or after
mf = mutual funds
noitta = notice of intent to terminate after
pateo/a = plan amendments taking effect on or after
pea = plans established after
po/a = purchases on or after
proaa = payments received or accrued after
pyba = plan years beginning after
raa = rights awarded after
rma = requests made after
sa = sales after
sbwi = stock becoming worthless in
ta = transfers after
tba = transportation beginning after
tdapma = transfers, distributions, and payments made after
teio/a = transactions entered into on or after
to/a = transactions on or after
tmi = transfers made in
tyba = taxable years beginning after
tybb = taxable years beginning before
tyea = taxable years ending after
wpoifibwa = wages paid or incurred for individuals beginning work after
yba = years beginning after
30da = 30 days after

[1] Gain of less than $500,000.
[2] Estimate considers interaction with HOPE and Lifetime Learning tax credits.
[3] Loss of less than $500,000.
[4] Estimate assumes concurrent enactment of the above-the-line deduction for long-term care insurance (item 2. under Health Care Tax Relief Provisions).
[5] Effective for vaccine sales the date after the date on which the Centers for Disease Control make final recommendation for routine administration of conjugate Streptococcus Pneumoniae vaccines to children.
[6] Estimate does not include outlay effects of renewal community provision.
[7] Provision includes interaction with other provisions in Provisions for Expanding Coverage.
[8] Provision includes interaction with the IRA provisions in II., Savings and Investment Tax Relief Provisions.
[9] Estimate provided by the Congressional Budget Office.

[Footnotes for the Table continued on the following page]

Footnotes for the Table continued:

[10] Loss of less than $5 million.
[11] Effective for distributions from terminating plans that occur after the PBGC has adopted final regulations implementing provision.
[12] Directs the Secretary of the Treasury to modify rules through regulations.
[13] Effective for payments received after 12/31/99 with respect to all officers.
[14] Loss of less than $1 million.
[15] Extension of credit effective for expenses incurred after 6/30/99; increase in AIC rates effective for taxable years beginning after 6/30/99.
[16] For wind and closed-loop biomass, provision applies to production from facilities placed in service after 6/30/99 and before 7/1/04; for poultry waste and landfill gas, provision applies to production from facilities placed in service after 12/31/99 and before 7/1/04; for other biomass, provision applies to production after 12/31/99 from facilities placed in service before 1/1/03.
[17] Effective for transfers made after 2/8/99 and for premiums paid after the date of enactment.
[18] Effective 7/14/99 (except with respect to partnerships in existence on 7/14/99, the provision in effective on the date of enactment).
[19] Effective with respect to ESOPs established on or after July 15,1999; in the case of an ESOP established by an S corporation before such date, the provision would apply to plan years beginning after 12/31/00.
[20] Gain of less than $10 million.

For consideration of the House bill, and the Senate amendment, and modifications committed to conference:

WM. ARCHER.
DICK ARMEY.
PHILIP M. CRANE.
WM. THOMAS.

As additional conferees for consideration of sections 313, 315–316, 318, 325, 335, 338, 341–42, 344–45, 351, 362–63, 365, 371, 381, 1261, 1305, and 1406 of the Senate amendment, and modifications committed to conference:

BILL GOODLING.
JOHN BOEHNER.
Managers on the Part of the House.

WM. V. ROTH, Jr.
TRENT LOTT.
Managers on the Part of the Senate.

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