

107TH CONGRESS  
2D SESSION

# H. R. 5505

To simplify certain provisions of the Internal Revenue Code of 1986 and to establish a uniform pass-thru regime.

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## IN THE HOUSE OF REPRESENTATIVES

OCTOBER 1, 2002

Mr. HOUGHTON introduced the following bill; which was referred to the Committee on Ways and Means

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## A BILL

To simplify certain provisions of the Internal Revenue Code of 1986 and to establish a uniform pass-thru regime.

1       *Be it enacted by the Senate and House of Representa-*  
2       *tives of the United States of America in Congress assembled,*

3       **SECTION 1. SHORT TITLE; ETC.**

4       (a) **SHORT TITLE.**—This Act may be cited as the  
5       “Individual and Small Business Tax Simplification Act of  
6       2002”.

7       (b) **REFERENCES TO INTERNAL REVENUE CODE OF**  
8       1986.—Except as otherwise expressly provided, whenever  
9       in this Act an amendment or repeal is expressed in terms  
10      of an amendment to, or repeal of, a section or other provi-

1 sion, the reference shall be considered to be made to a  
 2 section or other provision of the Internal Revenue Code  
 3 of 1986.

4 (c) TABLE OF CONTENTS.—

Sec. 1. Short title; etc.

TITLE I—INDIVIDUAL INCOME TAX SIMPLIFICATION

Subtitle A—General Provisions

- Sec. 101. Alternative minimum tax reform.
- Sec. 102. Head of household filing status replaced with special personal exemption.
- Sec. 103. Simplification of tax on social security benefits.
- Sec. 104. Simplification of capital gains tax.
- Sec. 105. Repeal of 2-percent floor on miscellaneous itemized deductions.
- Sec. 106. Simplification of deduction for points on home mortgage.
- Sec. 107. Taxation of minor children.
- Sec. 108. Simplification of dependent care tax benefits.
- Sec. 109. Acceleration of phaseout of overall limitation on itemized deductions.
- Sec. 110. Acceleration of repeal of phaseout of personal exemptions.

Subtitle B—Uniform Definition of Child

- Sec. 121. Uniform definition of child.
- Sec. 122. Treatment of government benefits in determining support and cost of maintaining household.
- Sec. 123. Effective date.

Subtitle C—Education Tax Incentives

- Sec. 131. Hope and Lifetime Learning credits combined.
- Sec. 132. Uniform definition of qualifying higher education expenses.

TITLE II—SMALL BUSINESS TAX SIMPLIFICATION

- Sec. 201. Unified pass-thru entity regime.
- Sec. 202. Increase in expensing under section 179.
- Sec. 203. Rollover of property held for productive use or investment.
- Sec. 204. Repeal of collapsible corporations.
- Sec. 205. References to general partners.
- Sec. 206. References to limited partners.
- Sec. 207. Partnership income attributable to capital excluded from net earnings from self-employment.
- Sec. 208. Repeal of ability to elect large partnership reporting rules.

1 **TITLE I—INDIVIDUAL INCOME**  
2 **TAX SIMPLIFICATION**  
3 **Subtitle A—General Provisions**

4 **SEC. 101. ALTERNATIVE MINIMUM TAX REFORM.**

5 (a) INCREASE IN ALTERNATIVE MINIMUM TAX EX-  
6 EMPTION AMOUNT.—

7 (1) Subparagraph (A) of section 55(d)(1) (re-  
8 lating to exemption amount for taxpayers other than  
9 corporations) is amended by striking “\$45,000” and  
10 all that follows through “2004)” and inserting  
11 “\$75,000”.

12 (2) Subparagraph (B) of section 55(d)(1) is  
13 amended by striking “\$33,750” and all that follows  
14 through “2004)” and inserting “\$56,000”.

15 (b) ADJUSTMENT FOR INFLATION.—Subsection (d)  
16 of section 55 is amended by adding at the end the fol-  
17 lowing new paragraph:

18 “(4) INFLATION ADJUSTMENT.—

19 “(A) IN GENERAL.—In the case of a tax-  
20 able year beginning in a calendar year after  
21 2003, each of the dollar amounts contained in  
22 subparagraphs (A) and (B) of paragraph (1)  
23 shall be increased by an amount equal to—

24 “(i) such dollar amount, multiplied by

1           “(ii) the cost-of-living adjustment de-  
2           termined under section 1(f)(3) for the cal-  
3           endar year in which the taxable year be-  
4           gins, determined by substituting ‘calendar  
5           year 2002’ for ‘calendar year 1992’ in sub-  
6           paragraph (B) thereof.

7           “(B) ROUNDING.—Any increase deter-  
8           mined under subparagraph (A) shall be rounded  
9           to the nearest multiple of \$100.”.

10       (c) REPEAL OF LIMIT ON DEDUCTION FOR STATE  
11       AND LOCAL TAXES.—Subparagraph (A) of section  
12       56(b)(1) is amended to read as follows:

13           “(A) IN GENERAL.—No deduction shall be  
14           allowed for any miscellaneous itemized deduc-  
15           tion (as defined in section 67(b)).”.

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

19       **SEC. 102. HEAD OF HOUSEHOLD FILING STATUS REPLACED**  
20       **WITH SPECIAL PERSONAL EXEMPTION.**

21       (a) INCREASED PERSONAL EXEMPTION FOR SINGLE  
22       PARENTS, ETC.—Section 151 is amended by redesi-  
23       gnating subsections (d) and (e) as subsection (e) and (f)  
24       and by inserting after subsection (c) the following new  
25       subsection:

1       “(d) ADDITIONAL EXEMPTION FOR SINGLE PAR-  
2 ENTS, ETC.—

3               “(1) IN GENERAL.—An exemption of \$3,700 in  
4 the case of an individual who—

5                       “(A) is not married at the close of the tax-  
6 able year,

7                       “(B) is not a surviving spouse, and

8                       “(C)(i) maintains as his home a household  
9 which constitutes for more than one-half of  
10 such taxable year the principal place of abode,  
11 as a member of such household, of—

12                               “(I) a qualifying child (as defined in  
13 subsection (c)), or

14                               “(II) any other person who is a de-  
15 pendent of the taxpayer, if the taxpayer is  
16 entitled to a deduction for the taxable year  
17 for such person under subsection (c), or

18                               “(ii) maintains a household which con-  
19 stitutes for such taxable year the principal place  
20 of abode of the father or mother of the tax-  
21 payer, if the taxpayer is entitled to a deduction  
22 for the taxable year for such father or mother  
23 under subsection (c).

24       For purposes of this paragraph, an individual shall  
25       be considered as maintaining a household only if

1 over half of the cost of maintaining the household  
2 during the taxable year is furnished by such indi-  
3 vidual.

4 “(2) MARITAL STATUS.—Marital status shall be  
5 determined in accordance with section 7703; except  
6 that an individual shall be treated as not married for  
7 purposes of this subsection if at any during such  
8 year the spouse of such individual is a nonresident  
9 alien.

10 “(3) LIMITATIONS.—Paragraph (1) shall not  
11 apply to any individual—

12 “(A) if at any time during the taxable year  
13 he is a nonresident alien, or

14 “(B) by reason of an individual who would  
15 not be a dependent for the taxable year but  
16 for—

17 “(i) paragraph (9) of section 152(a),

18 or

19 “(ii) subsection (c) of section 152.

20 “(4) INFLATION ADJUSTMENT.—

21 “(A) IN GENERAL.—In the case of a tax-  
22 able year beginning in a calendar year after  
23 2003, the dollar amount contained in paragraph  
24 (1) shall be increased by an amount equal to—

25 “(i) such dollar amount, multiplied by

1           “(ii) the cost-of-living adjustment de-  
2           termined under section 1(f)(3) for the cal-  
3           endar year in which the taxable year be-  
4           gins, determined by substituting ‘calendar  
5           year 2002’ for ‘calendar year 1992’ in sub-  
6           paragraph (B) thereof.

7           “(B) ROUNDING.—Any increase deter-  
8           mined under subparagraph (A) shall be rounded  
9           to the nearest multiple of \$50.”.

10       (b) REPEAL OF HEAD OF HOUSEHOLD FILING STA-  
11 TUS.—Subsection (b) of section 1 (relating to heads of  
12 household) is repealed.

13       (c) CONFORMING AMENDMENTS.—

14           (1) Section 1(c) is amended—

15               (A) in the heading by striking “SPOUSES  
16               AND HEADS OF HOUSEHOLDS).—” and insert-  
17               ing “SPOUSES).—”, and

18               (B) by striking “or the head of a house-  
19               hold as defined in section 2(b)”.

20           (2) Section 2 is amended by striking subsection  
21           (b) and by redesignating subsections (c), (d), and (e)  
22           as subsections (b), (c), and (d), respectively.

23           (3) Section 25B(b) is amended by striking the  
24           portion of the table related to head of a household.

25           (4) Section 63(c)(2) is amended—

1 (A) by striking subparagraph (B), and  
2 (B) by redesignating subparagraphs (C)  
3 and (D) as subparagraphs (B) and (C), respec-  
4 tively.

5 (5) Section 151(c)(6)(B)(iii) is amended by  
6 striking “or a head of a household (as such terms  
7 are defined in section 2)” and inserting “(as defined  
8 in section 2)”.

9 (6) Section 151(c)(6)(C) is amended by striking  
10 “, section 2(b)(1)(A),”.

11 (7) Section 151(e)(3)(C) is amended—

12 (A) by striking clause (ii),

13 (B) in clause (iii), by striking “or head of  
14 a household”, and

15 (C) by redesignating clauses (iii) and (iv)  
16 as clauses (ii) and (iii), respectively.

17 (8) Section 3402(r)(2)(A) is amended by strik-  
18 ing “section 63(c)(2)(C)” and inserting “section  
19 63(c)(2)(B)”.

20 (9) Section 6012(a)(1)(A) is amended—

21 (A) in clause (i), by striking “is not a head  
22 of a household (as defined section 2(b)),”,

23 (B) by striking clause (ii),

24 (C) by redesignating clauses (iii) and (iv)  
25 as clauses (ii) and (iii), respectively, and



1 (D) in the last sentence, by striking  
2 “Clause (iv)” and inserting “Clause (iii)” and  
3 by striking “151(c)” and inserting “151(d)”.

4 (10) Section 6012(a)(1)(B) is amended—

5 (A) by striking “clause (i), (ii), or (iii)”  
6 and inserting “clause (i) or (ii)”, and

7 (B) by striking “clause (iv)” and inserting  
8 “clause (iii)”.

9 (11)(A) Paragraph (6) of section 1(f) is amend-  
10 ed by striking “151(d)(4)(A)” and inserting  
11 “151(e)(4)(A)”.

12 (B) Subparagraph (C) of section 642(b)(2), as  
13 amended by section 105, is amended—

14 (i) by striking “151(d)” and inserting  
15 “151(e)”, and

16 (ii) by striking “151(d)(3)(C)(iii)” and in-  
17 serting “151(e)(3)(C)(ii)”.

18 (C) Paragraph (1) of section 3402(f) is amend-  
19 ed by striking “151(d)(2)” and inserting  
20 “151(e)(2)”.

21 (D) Subparagraph (B) of section 3402(r)(2) is  
22 amended by striking “151(d)” and inserting  
23 “151(e)”.

24 (E) Clause (ii) of section 6012(a)(1)(D) is  
25 amended—

1 (i) by striking “151(d)” and inserting  
2 “151(e)”, and

3 (ii) by striking “151(d)(2)” and inserting  
4 “151(e)(2)”.

5 (F) The next to the last sentence of section  
6 6013(b)(3)(A) is amended by striking “151(d)” and  
7 inserting “151(e)”.

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

11 **SEC. 103. SIMPLIFICATION OF TAX ON SOCIAL SECURITY**

12 **BENEFITS.**

13 (a) REPEAL OF 1993 INCREASE.—

14 (1) IN GENERAL.—Subsection (a) of section 86  
15 (relating to social security and tier 1 railroad retire-  
16 ment benefits) is amended to read as follows:

17 “(a) IN GENERAL.—Gross income for the taxable  
18 year of any taxpayer described in subsection (b) (notwith-  
19 standing section 207 of the Social Security Act) includes  
20 social security benefits in an amount equal to the lesser  
21 of—

22 “(1) one-half of the social security benefits re-  
23 ceived during the taxable year, or

24 “(2) one-half of the excess described in sub-  
25 section (b)(1).”

1 (2) CONFORMING AMENDMENTS.—

2 (A) Subsection (c) of section 86 is amend-  
3 ed to read as follows:

4 “(c) BASE AMOUNT.—For purposes of this section,  
5 the term ‘base amount’ means—

6 “(1) except as otherwise provided in this sub-  
7 section, \$25,000,

8 “(2) \$32,000 in the case of a joint return, and

9 “(3) zero in the case of a taxpayer who—

10 “(A) is married as of the close of the tax-  
11 able year (within the meaning of section 7703)  
12 but does not file a joint return for such year,  
13 and

14 “(B) does not live apart from his spouse at  
15 all times during the taxable year.”

16 (B) Paragraph (3) of section 871(a) is  
17 amended by striking “85 percent” in subpara-  
18 graph (A) and inserting “50 percent”.

19 (C)(i) Subparagraph (A) of section  
20 121(e)(1) of the Social Security Amendments of  
21 1983 (Public Law 98–21) is amended—

22 (I) by striking “(A) There” and in-  
23 sserting “There”;

24 (II) by striking “(i)” immediately fol-  
25 lowing “amounts equivalent to”; and

1 (III) by striking “, less (ii)” and all  
2 that follows and inserting a period.

3 (ii) Paragraph (1) of section 121(e) of  
4 such Act is amended by striking subparagraph  
5 (B).

6 (iii) Paragraph (3) of section 121(e) of  
7 such Act is amended by striking subparagraph  
8 (B) and by redesignating subparagraph (C) as  
9 subparagraph (B).

10 (iv) Paragraph (2) of section 121(e) of  
11 such Act is amended in the first sentence by  
12 striking “paragraph (1)(A)” and inserting  
13 “paragraph (1)”.

14 (b) USE OF ADJUSTED GROSS INCOME WITHOUT  
15 MODIFICATIONS.—

16 (1) IN GENERAL.—Subsection (b) of section 86  
17 is amended to read as follows:

18 “(b) TAXPAYERS TO WHOM SUBSECTION (a) AP-  
19 PLIES.—A taxpayer is described in this subsection if—

20 “(1) the sum of—

21 “(A) the adjusted gross income of the tax-  
22 payer for the taxable year (determined without  
23 regard to this section), plus

24 “(B) one-half of the social security benefits  
25 received during the taxable year, exceeds

1 “(2) the base amount.”

2 (2) CONFORMING AMENDMENTS.—

3 (A) Subparagraph (A) of section 219(g)(3)  
4 is amended—

5 (i) by striking “sections 86 and 469”  
6 in clause (i) and inserting “section 469”,  
7 and

8 (ii) by inserting “86,” before “135” in  
9 clause (ii).

10 (B) Paragraph (4) of section 135(c) is  
11 amended—

12 (i) by inserting “86,” before “137” in  
13 clause (i), and

14 (ii) by striking “sections 86, 469,” in  
15 clause (ii) and inserting “sections 469”.

16 (C) Paragraph (3) of section 137(b) is  
17 amended—

18 (i) by inserting “86,” before “221” in  
19 clause (i), and

20 (ii) by striking “86,” in clause (ii).

21 (D) Subparagraph (C) of section 221(b)(2)  
22 is amended—

23 (i) by inserting “86,” before “222” in  
24 clause (i), and

25 (ii) by striking “86,” in clause (ii).

1 (E) Subparagraph (C) of section 222(b)(2)  
2 is amended—

3 (i) by inserting “86,” before “911” in  
4 clause (i), and

5 (ii) by striking “86,” in clause (ii).

6 (c) EFFECTIVE DATES.—

7 (1) IN GENERAL.—Except as provided in para-  
8 graphs (2) and (3), the amendments made by this  
9 section shall apply to taxable years beginning after  
10 December 31, 2002.

11 (2) SUBSECTION (a)(2)(B).—The amendment  
12 made by subsection (a)(2)(B) shall apply to benefits  
13 paid after December 31, 2002.

14 (3) SUBSECTION (a)(2)(C).—The amendments  
15 made by subsection (a)(2)(C) shall apply to tax li-  
16 abilities for taxable years beginning after December  
17 31, 2002.

18 (d) MAINTENANCE OF TRANSFERS TO HOSPITAL IN-  
19 SURANCE TRUST FUND.—There are hereby appropriated  
20 to the Hospital Insurance Trust Fund established under  
21 section 1817 of the Social Security Act amounts equal to  
22 the reduction in revenues to the Treasury by reason of  
23 the enactment of this Act. Amounts appropriated by the  
24 preceding sentence shall be transferred from the general  
25 fund at such times and in such manner so as to replicate

1 to the extent possible the transfers which would have oc-  
2 curred to such Trust Fund had this Act not been enacted.

3 **SEC. 104. SIMPLIFICATION OF CAPITAL GAINS TAX.**

4 (a) IN GENERAL.—Part I of subchapter P of chapter  
5 1 (relating to treatment of capital gains) is amended by  
6 adding at the end the following new section:

7 **“SEC. 1203. CAPITAL GAINS DEDUCTION.**

8 “If for any taxable year a taxpayer other than a cor-  
9 poration has a net capital gain, 50 percent of such gain  
10 shall be a deduction from gross income.”.

11 (b) DEDUCTION ALLOWABLE WHETHER OR NOT  
12 TAXPAYER ITEMIZES OTHER DEDUCTIONS.—

13 (1) Subsection (b) of section 63 is amended by  
14 striking “and” at the end of paragraph (1), by strik-  
15 ing the period at the end of paragraph (2) and in-  
16 sserting “, and”, and by adding at the end the fol-  
17 lowing new paragraph:

18 “(3) the deduction allowed by section 1203.”.

19 (2) Subsection (d) of section 63 is amended by  
20 striking “and” at the end of paragraph (1), by strik-  
21 ing the period at the end of paragraph (2) and in-  
22 sserting “, and”, and by adding at the end the fol-  
23 lowing new paragraph:

24 “(3) the deduction allowed by section 1203.”.

25 (c) MINIMUM TAX TREATMENT.—

1           (1) Paragraph (1) of section 56(b) is amended  
2           by adding at the end the following new subpara-  
3           graph:

4                     “(G) CAPITAL GAIN DEDUCTION NOT AP-  
5                     PLICABLE.—Section 1203 shall not apply.”.

6           (2) Subsection (b) of section 55 is amended by  
7           striking paragraph (3) and inserting the following  
8           new paragraphs:

9                     “(3) MAXIMUM TAX ON NET CAPITAL GAIN.—  
10           The amount of tax determined under the first sen-  
11           tence of paragraph (1)(A)(i) shall not exceed the  
12           sum of—

13                     “(A) the amount determined under such  
14           first sentence computed at the rates and in the  
15           same manner as if this paragraph had not been  
16           enacted on the taxable excess reduced by the  
17           net capital gain, plus

18                     “(B) a tax on the net capital gain deter-  
19           mined by using the regular tax capital gains tax  
20           rates.

21                     “(4) REGULAR TAX ON NET CAPITAL GAIN.—  
22           For purposes of paragraph (3), the tax on the net  
23           capital gain determined by using the regular tax  
24           capital gains tax rates is the excess of—



1           “(A) the tax that would be computed  
2           under section 1 if net capital gain were deter-  
3           mined with the adjustments under this part,  
4           over

5           “(B) the tax that would be so computed  
6           under section 1 if the taxable income were re-  
7           duced by 50 percent of the net capital gain as  
8           so determined.”.

9           (d) TECHNICAL AND CONFORMING AMENDMENTS.—

10           (1) Section 1 is amended by striking subsection  
11           (h).

12           (2) Paragraph (7) of section 57(a) is amended  
13           by striking the last sentence.

14           (3) Subparagraph (E) of section 163(d)(4) is  
15           amended to read as follows:

16           “(E) COORDINATION WITH CAPITAL GAINS  
17           DEDUCTION.—The net capital gain taken into  
18           account under section 1203 for any taxable  
19           year shall be reduced (but not below zero) by  
20           the amount which the taxpayer takes into ac-  
21           count as investment income under subpara-  
22           graph (B)(iii) for such year.”.

23           (4) Paragraph (1) of section 170(e) is amended  
24           by striking “the amount of gain” in the material fol-  
25           lowing subparagraph (B)(ii) and inserting “50 per-

1 cent (100 percent in the case of a corporation) of  
2 the amount of gain”.

3 (5) Subparagraph (B) of section 172(d)(2) is  
4 amended to read as follows:

5 “(B) the exclusion under section 1202 and  
6 the deduction under section 1203 shall not be  
7 allowed.”.

8 (6) The last sentence of section 453A(c)(3) is  
9 amended by striking all that follows “long-term cap-  
10 ital gain,” and inserting “the maximum rate on net  
11 capital gain under section 1201 or the deduction  
12 under section 1203 (whichever is appropriate) shall  
13 be taken into account.”.

14 (7)(A) Section 641(c)(2)(A) is amended by  
15 striking “Except as provided in section 1(h), the”  
16 and inserting “The”.

17 (B) Section 641(c)(2)(C) is amended by insert-  
18 ing after clause (iii) the following new clause:

19 “(iv) The deduction under section  
20 1203.”.

21 (8) Paragraph (4) of section 642(c) is amended  
22 to read as follows:

23 “(4) ADJUSTMENTS.—To the extent that the  
24 amount otherwise allowable as a deduction under  
25 this subsection consists of gain from the sale or ex-

1 change of capital assets held for more than 1 year,  
2 proper adjustment shall be made for any exclusion  
3 allowable under section 1202 and any deduction al-  
4 lowable under section 1203 to the estate or trust. In  
5 the case of a trust, the deduction allowed by this  
6 subsection shall be subject to section 681 (relating  
7 to unrelated business income).”.

8 (9) Section 642 is amended by adding at the  
9 end the following new subsection:

10 “(j) CAPITAL GAINS DEDUCTION.—The deduction  
11 under section 1203 to an estate or trust shall be computed  
12 by excluding the portion (if any) of the gains for the tax-  
13 able year which is includible by the income beneficiaries  
14 under sections 652 and 662 (relating to inclusions of  
15 amounts in gross income of beneficiaries of trusts) as gain  
16 derived from the sale or exchange of capital assets.”.

17 (10) The last sentence of section 643(a)(3) is  
18 amended to read as follows: “The exclusion under  
19 section 1202 and the deduction under section 1203  
20 shall not be taken into account.”.

21 (11) Subparagraph (C) of section 643(a)(6) is  
22 amended by inserting “(i)” before “there shall” and  
23 by inserting before the period “, and (ii) the deduc-  
24 tion under section 1203 (relating to capital gains de-  
25 duction) shall not be taken into account”.

1           (12) Paragraph (4) of section 691(c) is amend-  
2           ed by striking “1(h),” and by inserting “1203,”  
3           after “1202,”.

4           (13) The second sentence of paragraph (2) of  
5           section 871(a) is amended by striking “section  
6           1202” and inserting “sections 1202 and 1203”.

7           (14)(A) Paragraph (2) of section 904(b) is  
8           amended by striking subparagraphs (A) and (C), by  
9           redesignating subparagraph (B) as subparagraph  
10          (A), and by inserting after subparagraph (A) (as so  
11          redesignated) the following new subparagraph:

12                   “(B) OTHER TAXPAYERS.—In the case of  
13                   a taxpayer other than a corporation, taxable in-  
14                   come from sources outside the United States  
15                   shall include gain from the sale or exchange of  
16                   capital assets only to the extent of foreign  
17                   source capital gain net income.”.

18          (B) Subparagraph (A) of section 904(b)(2), as  
19          so redesignated, is amended—

20                   (i) by striking all that precedes clause (i)  
21                   and inserting the following:

22                           “(A) CORPORATIONS.—In the case of a  
23                           corporation—”, and

24                   (ii) by striking in clause (i) “in lieu of ap-  
25                   plying subparagraph (A),”.

1 (C) Paragraph (3) of section 904(b) is amended  
2 by striking subparagraphs (D) and (E) and inserting  
3 the following new subparagraph:

4 “(D) RATE DIFFERENTIAL PORTION.—The  
5 rate differential portion of foreign source net  
6 capital gain, net capital gain, or the excess of  
7 net capital gain from sources within the United  
8 States over net capital gain, as the case may  
9 be, is the same proportion of such amount as  
10 the excess of the highest rate of tax specified in  
11 section 11(b) over the alternative rate of tax  
12 under section 1201(a) bears to the highest rate  
13 of tax specified in section 11(b).”.

14 (15) Paragraph (1) of section 1402(i) is amend-  
15 ed by inserting “, and the deduction provided by sec-  
16 tion 1203 shall not apply” before the period at the  
17 end thereof.

18 (16) Paragraph (1) of section 1445(e) is  
19 amended by striking “20 percent” and inserting  
20 “one-half of the maximum rate of tax in effect under  
21 section 1”.

22 (17)(A) The second sentence of section  
23 7518(g)(6)(A) is amended—

24 (i) by striking “during a taxable year to  
25 which section 1(h) or 1201(a) applies”, and

1 (ii) by striking “20 percent” and inserting  
2 “one-half of the maximum rate of tax in effect  
3 under section 1”.

4 (B) The second sentence of section  
5 607(h)(6)(A) of the Merchant Marine Act, 1936, is  
6 amended—

7 (i) by striking “during a taxable year to  
8 which section 1(h) or 1201(a) of such Code ap-  
9 plies”, and

10 (ii) by striking “20 percent” and inserting  
11 “one-half of the maximum rate of tax in effect  
12 under section 1 of such Code”.

13 (e) CLERICAL AMENDMENT.—The table of sections  
14 for part I of subchapter P of chapter 1 is amended by  
15 adding at the end the following new item:

“Sec. 1203. Capital gains deduction.”.

16 (f) EFFECTIVE DATES.—

17 (1) IN GENERAL.—Except as otherwise pro-  
18 vided in this subsection, the amendments made by  
19 this section shall apply to taxable years beginning  
20 after December 31, 2002.

21 (2) WITHHOLDING.—The amendments made by  
22 subsection (d)(16) shall apply only to amounts paid  
23 after December 31, 2002.

24 (3) COORDINATION WITH PRIOR TRANSITION  
25 RULE.—Any amount treated as long-term capital

1 gain by reason of paragraph (3) of section 1122(h)  
2 of the Tax Reform Act of 1986 shall not be taken  
3 into account for purposes of applying section 1203  
4 of the Internal Revenue Code of 1986 (as added by  
5 this section).

6 **SEC. 105. REPEAL OF 2-PERCENT FLOOR ON MISCELLA-**  
7 **NEOUS ITEMIZED DEDUCTIONS.**

8 (a) **TERMINATION.**—Section 67 (relating to 2-percent  
9 floor on miscellaneous itemized deductions) is hereby re-  
10 pealed.

11 (b) **CONFORMING AMENDMENTS.**—

12 (1) Subparagraph (A) of section 56(b)(1), as  
13 amended by section 101, is hereby repealed.

14 (2) Clause (i) of section 642(b)(2)(C) is amend-  
15 ed to read as follows:

16 “(i) **IN GENERAL.**—A qualified dis-  
17 ability trust shall be allowed a deduction  
18 equal to the exemption amount under sec-  
19 tion 151(d), determined by treating such  
20 trust as an individual described in section  
21 151(d)(3)(C)(iii).”

22 (3) Paragraph (3) of section 772(c) is amended  
23 to read as follows:

24 “(3) **INCOME OR LOSS FROM OTHER ACTIVI-**  
25 **TIES.**—For purposes of this chapter, any partner’s

1 distributive share of any income or loss described in  
2 subsection (a)(2) shall be treated as an item of in-  
3 come or expense (as the case may be) with respect  
4 to property held for investment.”

5 (4) Paragraph (3) of section 773(b) is hereby  
6 repealed.

7 (5) Clause (iii) of section 6654(d)(1)(C) is  
8 amended to read as follows:

9 “(iii) DETERMINATION OF ADJUSTED  
10 GROSS INCOME IN CASE OF ESTATES AND  
11 TRUSTS.—For purposes of this section, the  
12 adjusted gross income of an estate or trust  
13 shall be computed in the same manner as  
14 in the case of an individual, except that—

15 “(I) the deductions for costs  
16 which are paid or incurred in connec-  
17 tion with the administration of the es-  
18 tate or trust and which would not  
19 have been incurred if the property  
20 were not held in such trust or estate,  
21 and

22 “(II) the deductions allowable  
23 under sections 642(b), 651, and 661,  
24 shall be treated as allowable in arriv-  
25 ing at adjusted gross income. Under



1 regulations, appropriate adjustments  
2 shall be made in the application of  
3 part I of subchapter J of this chapter  
4 to take into account the provisions of  
5 this section.”

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

9 **SEC. 106. SIMPLIFICATION OF DEDUCTION FOR POINTS ON**  
10 **HOME MORTGAGE.**

11 (a) IN GENERAL.—Subsection (g) of section 461 (re-  
12 lating to prepaid interest) is amended by adding at the  
13 end the following new paragraph:

14 “(3) EXCEPTION FOR CERTAIN  
15 REFINANCINGS.—

16 “(A) IN GENERAL.—This subsection shall  
17 not apply to points paid in respect of indebted-  
18 ness secured by such residence resulting from  
19 the refinancing of indebtedness meeting the re-  
20 quirements of the preceding sentence (or this  
21 sentence).

22 “(B) LIMITATION.—Subparagraph (A)  
23 shall apply only to the extent the amount of the  
24 indebtedness resulting from such refinancing  
25 does not exceed the sum of—

1                   “(i) the amount of the refinanced in-  
2                   debtedness, plus

3                   “(ii) the lesser of \$10,000 or the  
4                   points paid in respect of the indebtedness  
5                   resulting from the refinancing to the ex-  
6                   tent that the indebtedness resulting from  
7                   the refinancing does not exceed the refi-  
8                   nanced indebtedness.”.

9           (b) CONFORMING AMENDMENT.—The heading of  
10 paragraph (2) of section 461(g) is amended by inserting  
11 “BASED ON BUSINESS PRACTICE” after “EXCEPTION”.

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

15 **SEC. 107. TAXATION OF MINOR CHILDREN.**

16           (a) APPLICATION OF TRUST RATE SCHEDULE TO  
17 NET UNEARNED INCOME OF MINOR CHILDREN.—Sub-  
18 section (g) of section 1 (relating to certain unearned in-  
19 come of minor children taxed as if parent’s income) is  
20 amended—

21                   (1) by striking paragraphs (1), (3) and (5),

22                   (2) by redesignating paragraphs (4), (6), and  
23                   (7) as paragraphs (3), (4), and (5), respectively, and

24                   (3) by inserting before paragraph (2) the fol-  
25                   lowing new paragraph:

1           “(1) IN GENERAL.—In the case of a child to  
2 whom this subsection applies, the tax imposed by  
3 this section shall be the sum of—

4                   “(A) a tax computed at the rates and in  
5 the same manner as if this subsection had not  
6 been enacted on taxable income reduced by net  
7 unearned income, plus

8                   “(B) the excess (if any) of the tax deter-  
9 mined under subsection (e) on total taxable in-  
10 come over the tax determined under subsection  
11 (e) on taxable income reduced by net unearned  
12 income.”.

13           (b) EXPANSION OF PARENTAL ELECTION.—Para-  
14 graph (5) of section 1(g) (as redesignated under sub-  
15 section (a)) is amended to read as follows:

16                   “(5) ELECTION TO CLAIM INCOME OF CHILD ON  
17 PARENT’S RETURN.—

18                   “(A) IN GENERAL.—If the parent of any  
19 child to whom this subsection applies elects the  
20 application of subparagraph (B), such child—

21                           “(i) shall be treated (other than for  
22 purposes of this paragraph)—

23                                   “(I) as having no gross income  
24 for such year, and

1                   “(II) as not being entitled to any  
2                   deductions or credits for such year,  
3                   and

4                   “(ii) shall not be required to file a re-  
5                   turn under section 6012 for such year.

6                   “(B) INCOME INCLUDED ON PARENT’S RE-  
7                   TURN.—In the case of a parent making the  
8                   election under this paragraph—

9                   “(i) the gross income of each child to  
10                  whom such election applies shall be in-  
11                  cluded in such parent’s gross income for  
12                  the taxable year,

13                  “(ii) the deductions to which such  
14                  child would be entitled without regard to  
15                  such election shall be allowed to such par-  
16                  ent but only to the extent the aggregate of  
17                  such deductions does not exceed the gross  
18                  income of such child,

19                  “(iii) any estimated tax payment, and  
20                  any amount which has been deducted and  
21                  withheld under chapter 24, for such year  
22                  that is made in the name and TIN of such  
23                  child shall be treated as an estimated tax  
24                  payment or as an amount deducted and  
25                  withheld in the name and TIN of such par-

1 ent for such year (including for purposes  
2 of section 31), and

3 “(iv) any interest which is an item of  
4 tax preference under section 57(a)(5) of  
5 the child shall be treated as an item of tax  
6 preference of such parent (and not of such  
7 child).

8 “(C) SPECIAL RULE FOR DETERMINING  
9 WHICH PARENT MAY MAKE ELECTION.—For  
10 purposes of this paragraph, the parent of a  
11 child to whom this subsection applies who may  
12 make an election under this paragraph shall  
13 be—

14 “(i) in the case of parents who are not  
15 married (within the meaning of section  
16 7703), the custodial parent (within the  
17 meaning of section 151(c)(7)) of the child,  
18 and

19 “(ii) in the case of married individuals  
20 filing separately, the individual with the  
21 greater taxable income.

22 “(D) CARRYOVERS ALLOWED.—Subpara-  
23 graph (A)(i)(II) shall not prohibit the carryover  
24 of any amount that the child would be entitled

1 to carryover without regard to the election  
2 under this paragraph.

3 “(E) REGULATIONS.—The Secretary shall  
4 prescribe such regulations as may be necessary  
5 or appropriate to carry out the purposes of this  
6 paragraph.”.

7 (c) CONFORMING AMENDMENT.—The heading for  
8 subsection (g) of section 1 is amended to read as follows:

9 “(g) TREATMENT OF CERTAIN INCOME OF MINOR  
10 CHILDREN.—”.

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

14 **SEC. 108. SIMPLIFICATION OF DEPENDENT CARE TAX BEN-**  
15 **EFITS.**

16 (a) REPEAL OF REDUCTION OF CREDIT BASED ON  
17 ADJUSTED GROSS INCOME.—Subsection (a) of section 21  
18 (relating to allowance of credit) is amended—

19 (1) in paragraph (1), by striking “applicable  
20 percentage” and inserting “35 percent”,

21 (2) by striking paragraph (2), and

22 (3) by striking “(1) IN GENERAL.—” and mov-  
23 ing the text 2 ems to the left.

1 (b) DOLLAR LIMIT ON AMOUNT CREDITABLE MADE  
2 \$5,500 REGARDLESS OF NUMBER OF QUALIFYING INDI-  
3 VIDUALS.—

4 (1) IN GENERAL.—Subsection (c) of section 21  
5 (relating to dollar limit on amount creditable) is  
6 amended to read as follows:

7 “(c) DOLLAR LIMIT ON AMOUNT CREDITABLE.—The  
8 amount of employment-related expenses incurred during  
9 any taxable year which may be taken into account under  
10 subsection (a) shall not exceed \$5,500, reduced by the ag-  
11 gregate amount excludable from gross income under sec-  
12 tion 129 for the taxable year.”.

13 (2) EXCLUSION.—Subparagraph (A) of section  
14 129(a)(2) is amended by striking “\$5,000 (\$2,500”  
15 and inserting “\$5,500 (\$2,750”.

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

19 **SEC. 109. ACCELERATION OF PHASEOUT OF PHASEOUT OF**  
20 **OVERALL LIMITATION ON ITEMIZED DEDUC-**  
21 **TIONS.**

22 (a) IN GENERAL.—Section 68 (relating to overall  
23 limitation on itemized deductions) is hereby repealed.

24 (b) CONFORMING AMENDMENTS.—





1           “(A) such dollar amount, multiplied by

2           “(B) the cost-of-living adjustment deter-  
3           mined under section 1(f)(3) for the calendar  
4           year in which the taxable year begins, by sub-  
5           stituting ‘calendar year 1988’ for ‘calendar year  
6           1992’ in subparagraph (B) thereof.”.

7           (2) Section 1(f)(6) is amended—

8           (A) in subparagraph (A) by striking  
9           “151(e)(4)” and inserting “151(e)(3)”, and

10           (B) in subparagraph (B), both as in effect  
11           on the date of the enactment of this Act and as  
12           amended by the Economic Growth and Tax Re-  
13           lief Reconciliation Act of 2001, by striking  
14           “151(e)(4)(A)” and inserting “151(e)(3)”.

15           (3) Subparagraph (C) of section 642(b)(2), as  
16           amended by the preceding sections of this Act, is  
17           amended by striking “, determined by treating such  
18           trust as an individual described in section  
19           151(e)(3)(C)(ii)”.

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

1     **Subtitle B—Uniform Definition of**  
2                                     **Child**

3     **SEC. 121. UNIFORM DEFINITION OF CHILD.**

4             (a) PERSONAL EXEMPTION.—

5                     (1) IN GENERAL.—Section 151, as amended by  
6             the preceding sections of this Act, is amended by re-  
7             designating subsections (c), (d), (e), and (f) as sub-  
8             sections (d), (e), (f), and (g), respectively, and by in-  
9             serting after subsection (b) the following new sub-  
10            section:

11            “(c) ADDITIONAL EXEMPTION FOR QUALIFYING  
12     CHILDREN.—

13                     “(1) IN GENERAL.—An exemption of the ex-  
14             emption amount for each qualifying child.

15                     “(2) QUALIFYING CHILD.—For purposes of this  
16             section, the term ‘qualifying child’ means, with re-  
17             spect to any taxpayer for any taxable year, an indi-  
18             vidual—

19                             “(A) who bears a relationship to the tax-  
20             payer described in paragraph (3),

21                             “(B) who has the same principal place of  
22             abode as the taxpayer for more than ½ of such  
23             taxable year, and

24                             “(C) who meets the age requirements of  
25             paragraph (4).

1 An individual shall not be treated as failing to meet  
2 the requirements of subparagraph (B) by reason of  
3 time of birth or death or by reason of temporary ab-  
4 sences or other circumstances specified in the regu-  
5 lations prescribed by the Secretary.

6 “(3) RELATIONSHIP TEST.—

7 “(A) IN GENERAL.—For purposes of para-  
8 graph (2)(A), an individual bears a relationship  
9 to the taxpayer described in this paragraph if  
10 such individual is—

11 “(i) a son, daughter, stepson, or step-  
12 daughter of the taxpayer or a descendant  
13 of any such relative,

14 “(ii) a brother, sister, stepbrother, or  
15 stepsister of the taxpayer or a descendant  
16 of any such relative, whom the taxpayer  
17 cares for as the taxpayer’s own child, or

18 “(iii) an eligible foster child of the  
19 taxpayer.

20 “(B) ADOPTED CHILD.—For purposes of  
21 subparagraph (A), a child who is legally adopt-  
22 ed, or who is placed with the taxpayer by an  
23 authorized placement agency for adoption by  
24 the taxpayer, shall be treated as a child by  
25 blood.

1           “(C) ELIGIBLE FOSTER CHILD.—For pur-  
2           poses of subparagraph (A), the term ‘eligible  
3           foster child’ means an individual—

4                   “(i) who is placed with the taxpayer  
5                   by an authorized placement agency or by  
6                   judgment, decree, or other order of any  
7                   court of competent jurisdiction, and

8                   “(ii) whom the taxpayer cares for as  
9                   the taxpayer’s own child.

10           “(4) AGE REQUIREMENTS.—For purposes of  
11           paragraph (2)(C), an individual meets the require-  
12           ments of this paragraph if such individual—

13                   “(A) has not attained the age of 19 as of  
14                   the close of the calendar year in which the tax-  
15                   able year of the taxpayer begins,

16                   “(B) is a student who has not attained the  
17                   age of 24 as of the close of such calendar year,  
18                   or

19                   “(C) is permanently and totally disabled  
20                   (as defined in section 22(e)(3)) at any time  
21                   during the taxable year.

22           “(5) SPECIAL RULES.—

23                   “(A) MARRIED DEPENDENTS.—An indi-  
24                   vidual shall not be a qualifying child of a tax-  
25                   payer if such individual makes a joint return

1 with the individual's spouse under section 6013  
2 for the taxable year beginning in the calendar  
3 year in which the taxable year of the taxpayer  
4 begins.

5 “(B) INDIVIDUALS WHO SUPPORT THEM-  
6 SELVES.—An individual shall not be a quali-  
7 fying child of a taxpayer if such individual pro-  
8 vides over half of such individual's own support  
9 for the calendar year in which the taxable year  
10 of the taxpayer begins.

11 “(C) ONLY 1 EXEMPTION AMOUNT.—An  
12 individual who is a qualifying child of any tax-  
13 payer shall not be treated as the dependent of  
14 any taxpayer for purposes of this part.

15 “(6) SPECIAL RULE RELATING TO 2 OR MORE  
16 CLAIMING QUALIFYING CHILD.—

17 “(A) IN GENERAL.—Except as provided in  
18 paragraph (7), if an individual would (but for  
19 this paragraph) be a qualifying child of 2 or  
20 more taxpayers for taxable years beginning in  
21 the same calendar year, such individual shall be  
22 treated as the qualifying child of the taxpayer  
23 who is—

24 “(i) a parent of the individual, or

1           “(ii) if none of such taxpayers is a  
2           parent of the individual, the taxpayer with  
3           the highest adjusted gross income for such  
4           taxable year.

5           “(B) PARENTS NOT FILING JOINT RE-  
6           TURNS.—If an individual would (but for this  
7           paragraph) be a qualifying child of both parents  
8           of such individual and such parents do not file  
9           a joint return together, such child shall be  
10          treated as the qualifying child of—

11           “(i) the parent with whom the child  
12           resided for the longest period during the  
13           taxable year, or

14           “(ii) if the child resides with both par-  
15           ents for the same length of time during  
16           such taxable year, the parent with the  
17           highest adjusted gross income.

18           “(C) FOSTER CHILDREN.—For purposes of  
19           this paragraph, the taxpayer shall be treated as  
20           a parent of any eligible foster child who has the  
21           same principal place of abode as the taxpayer  
22           for more than one-half of such taxable year.

23           “(7) SPECIAL RULE FOR CERTAIN PRE-2004 IN-  
24          STRUMENTS.—

1           “(A) IN GENERAL.—Notwithstanding para-  
2 graph (6), a child who has parents who—

3           “(i) are divorced or legally separated  
4 under a decree of divorce or separate  
5 maintenance,

6           “(ii) are separated under a written  
7 separation agreement, or

8           “(iii) live apart at all times during the  
9 last 6 months of the calendar year,

10 shall be treated as being the qualifying child of  
11 the noncustodial parent for a calendar year if  
12 the requirements of subparagraph (B) are met.

13           “(B) REQUIREMENTS.—For purposes of  
14 subparagraph (A), the requirements of this sub-  
15 paragraph are met if—

16           “(i) such child would, but for this  
17 paragraph, be the qualifying child of the  
18 custodial parent, and

19           “(ii) a qualified pre-2004 instrument  
20 between the parents is applicable to such  
21 child for the taxable year beginning in such  
22 calendar year.

23 In the case of an agreement executed before  
24 January 1, 1985, the requirements of this sub-  
25 paragraph are met only if, in addition to meet-

1           ing the requirements of clauses (i) and (ii), the  
2           noncustodial parent provides at least \$600 for  
3           the support of such child during such calendar  
4           year.

5           “(C) QUALIFIED PRE-2004 INSTRUMENT.—  
6           For purposes of this paragraph, the term  
7           ‘qualified pre-2004 instrument’ means any writ-  
8           ten declaration referred to in subsection (e)(2)  
9           (as in effect on the day before the date of the  
10          enactment of the Individual and Small Business  
11          Tax Simplification Act of 2002)—

12           “(i) which is executed before January  
13          1, 2004, and

14           “(ii) which is not modified on or after  
15          such date in a modification which expressly  
16          provides that this subsection shall not  
17          apply to such declaration.

18          “(D) CUSTODIAL PARENT AND NONCUSTO-  
19          DIAL PARENT.—For purposes of this sub-  
20          section—

21           “(i) CUSTODIAL PARENT.—The term  
22          ‘custodial parent’ means the parent with  
23          whom a child shared the same principal  
24          place of abode for the greater portion of  
25          the calendar year.



1           “(ii) NONCUSTODIAL PARENT.—The  
2           term ‘noncustodial parent’ means the par-  
3           ent who is not the custodial parent.

4           “(E) SPECIAL RULES FOR SUPPORT.—For  
5           purposes of this subsection—

6           “(i) amounts expended for the support  
7           of a child or children shall be treated as  
8           received from the noncustodial parent to  
9           the extent that such parent provided  
10          amounts for such support, and

11          “(ii) in the case of the remarriage of  
12          a parent, support of a child received from  
13          the parent’s spouse shall be treated as re-  
14          ceived from the parent.”.

15          (2) CONFORMING AMENDMENTS.—

16          (A) Section 152 is amended by striking  
17          subsection (g) (relating to support test in case  
18          of child of divorced parents, etc.), as redesign-  
19          ated by the preceding sections this Act.

20          (B) Paragraph (6) of section 1(f), as  
21          amended by the preceding sections of this Act,  
22          is amended by striking “151(e)(3)(A)” and in-  
23          serting “151(f)(3)(A)”.

24          (C) Paragraph (5) of section 21(e) is  
25          amended—

1 (i) by striking “paragraph (2) or (4)  
2 of section 152(e)” and inserting “section  
3 151(e)(7)”, and

4 (ii) by striking “section 152(e)(1)”  
5 and inserting “section 151(e)(7)”.

6 (D) Sections 21(e)(6) and 129(c) are each  
7 amended—

8 (i) by striking “151(c)” and inserting  
9 “151(d)”, and

10 (ii) by striking “151(c)(3)” and in-  
11 sserting “151(d)(3)”.

12 (E) Sections 25(e)(2)(B), 32(e)(3)(C)(ii),  
13 152(d)(2), and 2032A(e)(7)(D) are each  
14 amended by striking “151(c)(4)” and inserting  
15 “151(d)(4)”.

16 (F) Sections 72(t)(7)(A)(iii) and  
17 132(h)(2)(B) are each amended by striking  
18 “151(c)(3)” and inserting “151(d)(3)”.

19 (G) Subparagraph (C) of section  
20 642(b)(2), as amended by the preceding sec-  
21 tions of this Act, is amended by striking  
22 “151(e)” and inserting “151(f)”.

23 (H) Paragraph (1) of section 3402(f) is  
24 amended by striking “151(e)(2)” and inserting  
25 “151(f)(2)”.

1           (I) Subparagraph (B) of section  
2           3402(r)(2), as so amended, is amended by  
3           striking “151(e)” and inserting “151(f)”.

4           (J) Clause (ii) of section 6012(a)(1)(D), as  
5           so amended, is amended—

6                   (i) by striking “151(e)” and inserting  
7                   “151(f)”, and

8                   (ii) by striking “151(e)(2)” and in-  
9                   serting “151(f)(2)”.

10           (K) The last sentence of section  
11           6013(b)(3)(A), as so amended is amended by  
12           striking “151(e)” and inserting “151(f)”.

13           (b) APPLICATION OF UNIFORM DEFINITION TO DE-  
14           PENDENT CARE CREDIT.—Section 21(b)(1)(A) is amend-  
15           ed to read as follows:

16                   “(A) a qualifying child of the taxpayer (as  
17                   defined in section 151(c)) who has not attained  
18                   age 13,”.

19           (c) APPLICATION OF UNIFORM DEFINITION TO  
20           CHILD TAX CREDIT.—Section 24(c)(1) is amended to  
21           read as follows:

22                   “(1) IN GENERAL.—The term ‘qualifying child’  
23                   means a qualifying child of the taxpayer (as defined  
24                   in section 151(c)) who has not attained age 17 as

1 of the close of the calendar year in which the taxable  
2 year of the taxpayer begins.”.

3 (d) APPLICATION OF UNIFORM DEFINITION TO  
4 EARNED INCOME CREDIT.—

5 (1) IN GENERAL.—Paragraph (3) of section  
6 32(c) is amended to read as follows:

7 “(3) QUALIFYING CHILD.—

8 “(A) IN GENERAL.—The term ‘qualifying  
9 child’ means a qualifying child of the taxpayer  
10 (as defined in section 151(c)).

11 “(B) PLACE OF ABODE.—For purposes of  
12 subparagraph (A), the requirements of section  
13 151(c)(2)(B) shall be met only if the principal  
14 place of abode is in the United States.

15 “(C) IDENTIFICATION REQUIREMENTS.—

16 “(i) IN GENERAL—A qualifying child  
17 shall not be taken into account under sub-  
18 section (b) unless the taxpayer includes the  
19 name, age, and TIN of the qualifying child  
20 on the return of tax for the taxable year.

21 “(ii) OTHER METHODS.—The Sec-  
22 retary may prescribe other methods for  
23 providing the information described in  
24 clause (i).”.

25 (2) CONFORMING AMENDMENTS.—

1 (A) Section 32(c)(1) is amended by strik-  
2 ing subparagraph (C) and by redesignating sub-  
3 paragraphs (D), (E), (F), and (G) as subpara-  
4 graphs (C), (D), (E), and (F), respectively.

5 (B) Section 32(c)(4) is amended by strik-  
6 ing “(3)(E)” and inserting “(3)(B)”.

7 (C) Section 32(m) is amended by striking  
8 “subsections (c)(1)(F)” and inserting “sub-  
9 sections (c)(1)(E)”.

10 **SEC. 122. TREATMENT OF GOVERNMENT BENEFITS IN DE-**  
11 **TERMINING SUPPORT AND COST OF MAIN-**  
12 **TAINING HOUSEHOLD.**

13 (a) **DEPENDENCY EXEMPTION.**—Section 152 is  
14 amended by adding at the end the following new sub-  
15 section:

16 “(f) **SPECIAL RULE RELATING TO TREATMENT OF**  
17 **GOVERNMENT BENEFITS IN DETERMINING SUPPORT.**—  
18 For purposes of this part, any means-tested benefits ob-  
19 tained under programs described in section 6103(l)(7) or  
20 substantially similar government programs shall not be  
21 taken into account for purposes of determining—

22 “(1) whether over half of the support of an in-  
23 dividual for a calendar year is received from a tax-  
24 payer, and

1           “(2) whether over half of the cost of maintain-  
2           ing a household is furnished by a taxpayer.”.

3           (b) DEPENDENT CARE CREDIT.—Section 21(e)(1) is  
4           amended by adding at the end the following: “Any means-  
5           tested benefits obtained under programs described in sec-  
6           tion 6103(l)(7) or substantially similar government pro-  
7           grams shall not be taken into account for purposes of de-  
8           termining whether over half of the cost of maintaining a  
9           household is furnished by the individual.”.

10          (c) MARITAL STATUS.—Section 7703 (relating to de-  
11          termination of marital status) is amended by adding at  
12          the end the following new subsection:

13          “(c) SPECIAL RULE RELATING TO TREATMENT OF  
14          GOVERNMENT BENEFITS IN DETERMINING COST OF  
15          MAINTAINING HOUSEHOLD.—For purposes of subsection  
16          (b)(2), any means-tested benefits obtained under pro-  
17          grams described in section 6103(l)(7) or substantially  
18          similar government programs shall not be taken into ac-  
19          count for purposes of determining whether over half of the  
20          cost of maintaining a household is furnished by the indi-  
21          vidual.”.

22          **SEC. 123. EFFECTIVE DATE.**

23          The amendments made by this subtitle shall apply to  
24          taxable years beginning after December 31, 2002.

1                   **Subtitle C—Education Tax**  
2                   **Incentives**

3 **SEC. 131. HOPE AND LIFETIME LEARNING CREDITS COM-**  
4                   **BINED.**

5           (a) **IN GENERAL.**—So much of section 25A (relating  
6 to Hope and Lifetime Learning Credits) as precedes sub-  
7 section (d) is amended to read as follows:

8 **“SEC. 25A. EDUCATION CREDIT.**

9           “(a) **ALLOWANCE OF CREDIT.**—In the case of an in-  
10 dividual, there shall be allowed as a credit against the tax  
11 imposed by this chapter for the taxable year the amount  
12 equal to 50 percent of so much of the qualified expenses  
13 paid by the taxpayer during the taxable year (for edu-  
14 cation furnished to an individual during any academic pe-  
15 riod beginning in such taxable year) as does not exceed  
16 \$3,000 for such taxable year with respect to such indi-  
17 vidual.

18           “(b) **QUALIFIED EXPENSES.**—For purposes of sub-  
19 section (a), the term ‘qualified expenses’ means the sum  
20 of—

21                   “(1) qualified higher education expenses, and

22                   “(2) the expenses described in subsection (d)(1)  
23 with respect to any course of instruction at an eligi-  
24 ble educational institution to acquire or improve job  
25 skills of the individual.”.

1 (b) CONFORMING AMENDMENTS TO CREDIT.—

2 (1) Section 25A is amended—

3 (A) by striking subsection (h), and

4 (B) by redesignating subsections (e), (f),  
5 (g), and (i) as subsections (c), (d), (e), and (f),  
6 respectively.

7 (2) Subsection (e)(2) of section 25A, as so re-  
8 designated, is amended by striking “(before the ap-  
9 plication of subsections (b), (c), and (d))”.

10 (c) OTHER CONFORMING AND CLERICAL AMEND-  
11 MENTS.—

12 (1) The following provisions are each amended  
13 by striking “section 25A(g)(2)” and inserting “sec-  
14 tion 25A(e)(2)”:

15 (A) Section 72(t)(7)(B).

16 (B) Section 221(d)(2)(B).

17 (C) Section 222(d)(1) (as amended by sec-  
18 tion 132 of this Act).

19 (D) Section 529(e)(3)(B)(v)(I).

20 (E) Section 530(b)(2)(A).

21 (F) Section 530(d)(2)(C)(i)(I).

22 (G) Section 530(d)(4)(B)(iii).

23 (2) Section 221(d) is amended—



1 (A) in paragraph (2) by striking “section  
2 25A(f)(2)” and inserting “section 25A(d)(2)”,  
3 and

4 (B) by amending paragraph (3) to read as  
5 follows:

6 “(3) ELIGIBLE STUDENT.—The term ‘eligible  
7 student’ means, with respect to any academic period,  
8 a student who—

9 “(A) meets the requirements of section  
10 484(a)(1) of the Higher Education Act of 1965  
11 (20 U.S.C. 1091(a)(1)), as in effect on the date  
12 of the enactment of this section, and

13 “(B) is carrying at least  $\frac{1}{2}$  the normal  
14 full-time work load for the course of study the  
15 student is pursuing.”.

16 (3) Section 529(e)(3)(B)(i) is amended by strik-  
17 ing “section 25A(b)(3)” and inserting “section  
18 221(d)(3)”.

19 (4) The heading of section 529(e)(3)(B)(v) is  
20 amended to read as follows: “COORDINATION WITH  
21 EDUCATION CREDIT.—”.

22 (5) The heading of section 530(d)(2)(C) is  
23 amended to read as follows: “COORDINATION WITH  
24 EDUCATION CREDIT AND QUALIFIED TUITION PRO-  
25 GRAMS.—”.

1           (6) Section 6050S(e) is amended by striking  
2 “subsection (g)(2)” and inserting “subsection  
3 (e)(2)”.

4           (7) Section 6213(g)(2)(J) is amended by strik-  
5 ing “section 25A(g)(1)” and inserting “section  
6 25A(e)(1)”.

7           (8) The item relating to section 25A in the  
8 table of sections for subpart A of part IV of sub-  
9 chapter A of chapter 1 is amended to read as fol-  
10 lows:

“Sec. 25A. Education Credit.”.

11           (d) **EFFECTIVE DATE.**—The amendments made by  
12 this section shall apply to taxable years beginning after  
13 December 31, 2002.

14 **SEC. 132. UNIFORM DEFINITION OF QUALIFYING HIGHER**  
15 **EDUCATION EXPENSES.**

16           (a) **IN GENERAL.**—Paragraph (3) of section 529(e)  
17 (relating to other definitions and special rules) is amended  
18 to read as follows:

19                   “(3) **QUALIFIED HIGHER EDUCATION EX-**  
20 **PENSES.**—

21                           “(A) **IN GENERAL.**—The term ‘qualified  
22 higher education expenses’ means—

23                                   “(i) tuition, fees, books, supplies, and  
24 equipment required for the enrollment or

1 attendance of a designated beneficiary at  
2 an eligible educational institution; and

3 “(ii) expenses for special needs serv-  
4 ices in the case of a special needs bene-  
5 ficiary which are incurred in connection  
6 with such enrollment or attendance.

7 “(B) ROOM AND BOARD INCLUDED FOR  
8 STUDENTS WHO ARE AT LEAST HALF-TIME.—

9 “(i) IN GENERAL.—In the case of an  
10 individual who is an eligible student for  
11 any academic period, such term shall also  
12 include reasonable costs for such period (as  
13 determined under the qualified tuition pro-  
14 gram) incurred by the designated bene-  
15 ficiary for room and board while attending  
16 such institution. For purposes of sub-  
17 section (b)(7), a designated beneficiary  
18 shall be treated as meeting the require-  
19 ments of this clause.

20 “(ii) LIMITATION.—The amount treat-  
21 ed as qualified higher education expenses  
22 by reason of clause (i) shall not exceed—

23 “(I) the allowance (applicable to  
24 the student) for room and board in-  
25 cluded in the cost of attendance (as

1 defined in section 472 of the Higher  
2 Education Act of 1965 (20 U.S.C.  
3 1087*l*), as in effect on the date of the  
4 enactment of the Economic Growth  
5 and Tax Relief Reconciliation Act of  
6 2001) as determined by the eligible  
7 educational institution for such pe-  
8 riod, or

9 “(II) if greater, the actual invoice  
10 amount the student residing in hous-  
11 ing owned or operated by the eligible  
12 educational institution is charged by  
13 such institution for room and board  
14 costs for such period.

15 “(iii) ELIGIBLE STUDENT.—For pur-  
16 poses of this subparagraph, the term ‘eligi-  
17 ble student’ means, with respect to any  
18 academic period, a student who—

19 “(I) meets the requirements of  
20 section 484(a)(1) of the Higher Edu-  
21 cation Act of 1965 (20 U.S.C.  
22 1091(a)(1)), as in effect on the date  
23 of the enactment of this section, and

24 “(II) is carrying at least  $\frac{1}{2}$  the  
25 normal full-time work load for the

1 course of study the student is pur-  
2 suing.

3 “(C) EXCEPTIONS.—

4 “(i) EXCEPTION FOR EDUCATION IN-  
5 VOLVING SPORTS, ETC.—Such term does  
6 not include expenses with respect to any  
7 course or other education involving sports,  
8 games, or hobbies, unless such course or  
9 other education is part of the individual’s  
10 degree program.

11 “(ii) EXCEPTION FOR NONACADEMIC  
12 FEES.—Such term does not include stu-  
13 dent activity fees, athletic fees, insurance  
14 expenses, or other expenses unrelated to an  
15 individual’s academic course of instruc-  
16 tion.”.

17 (b) CONFORMING AMENDMENTS.—

18 (1) Section 25A and 6050S are each amended  
19 by striking “qualified tuition and related expenses”  
20 each place it appears and inserting “qualified higher  
21 education expenses”.

22 (2) Section 25A(f)(1) is amended to read as fol-  
23 lows:

24 “(1) QUALIFIED HIGHER EDUCATION EX-  
25 PENSES.—The term ‘qualified higher education ex-

1       penses’ means the qualified higher education ex-  
2       penses (as defined by section 529(e)(3) without re-  
3       gard to subparagraph (B) thereof) required for the  
4       enrollment or attendance of—

5               “(A) the taxpayer,

6               “(B) the taxpayer’s spouse, or

7               “(C) any dependent of the taxpayer with  
8       respect to whom the taxpayer is allowed a de-  
9       duction under section 151,

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

12      (3) Section 135(c)(2) is amended—

13              (A) by striking “tuition and fees” and in-  
14              serting “the qualified higher education expenses  
15              (as defined by section 529(e)(3) without regard  
16              to subparagraph (B) thereof)”, and

17              (B) by striking subparagraph (B) and re-  
18              designating subparagraph (C) as subparagraph  
19              (B).

20      (4) Section 221(d)(2) is amended by striking  
21      “the cost of attendance (as defined in section 472 of  
22      the Higher Education Act of 1965, 20 U.S.C.  
23      10871l, as in effect on the day before the date of the  
24      enactment of this Act)” and inserting “the qualified  
25      higher education expenses (as defined by section

1 529(e)(3) without regard to subparagraph (B) there-  
2 of) incurred for attendance”.

3 (5)(A) Section 222 is amended by striking  
4 “qualified tuition and related expenses” each place  
5 it appears and inserting “qualified higher education  
6 expenses”.

7 (B) Section 222(d)(1) is amended to read as  
8 follows:

9 “(1) QUALIFIED HIGHER EDUCATION EX-  
10 PENSES.—The term ‘qualified higher education ex-  
11 penses’ has the meaning given such term by section  
12 529(e)(3) (without regard to subparagraph (B)  
13 thereof). Such expenses shall be reduced in the same  
14 manner as under section 25A(g)(2).”.

15 (C) Section 222(d) is amended by redesignating  
16 paragraph (6) as paragraph (7) and by inserting  
17 after paragraph (5) the following new paragraph:

18 “(6) ROOM AND BOARD INCLUDED FOR STU-  
19 DENTS WHO ARE FULL-TIME.—No amount shall be  
20 taken into account under this section for an expense  
21 described in section 529(e)(3)(B) (relating to room  
22 and board included for students who are at least  
23 half-time) unless such individual is an eligible stu-  
24 dent (as defined in section 25A(b)(3), determined by  
25 substituting ‘the normal full-time work load’ in lieu

1 of ‘1/2 the normal full-time work load’ in subpara-  
 2 graph (B) thereof.”.

3 (D) The heading for section 222 is amended by  
 4 striking “**TUITION AND RELATED**” and in-  
 5 serting “**HIGHER EDUCATION**”.

6 (E) The table of sections for part VII of sub-  
 7 chapter B of chapter 1 is amended by amending the  
 8 item relating to section 222 to read as follows:

“Sec. 222. Qualified higher education expenses.”.

9 (6)(A) Section 6724(d) is amended—

10 (i) in paragraph (1)(B)(x) by striking  
 11 “qualified tuition and related expenses” and in-  
 12 serting “qualified higher education expenses”,  
 13 and

14 (ii) in paragraph (2)(Z) by striking “quali-  
 15 fied tuition and related expenses” and inserting  
 16 “qualified higher education expenses”.

17 (c) EFFECTIVE DATE.—The amendments made by  
 18 this section shall apply to amounts paid in taxable years  
 19 beginning after December 31, 2002, for education fur-  
 20 nished in periods beginning after such date.

## 21 **TITLE II—SMALL BUSINESS TAX** 22 **SIMPLIFICATION**

### 23 **SEC. 201. UNIFIED PASS-THRU ENTITY REGIME.**

24 (a) TERMINATION OF S CORPORATION STATUS.—



1           (1) NO NEW S CORPORATION ELECTIONS.—  
2           Subsection (a) of section 1362 is amended by adding  
3           at the end the following new paragraph:

4           “(3) TERMINATION OF AUTHORITY TO MAKE  
5           ELECTION.—No election may be made under para-  
6           graph (1) for any taxable year beginning after De-  
7           cember 31, 2002.”.

8           (2) TERMINATION OF STATUS.—Subsection (d)  
9           of section 1362 (relating to termination) is amended  
10          by adding at the end the following new paragraph:

11          “(4) TREATMENT AS PARTNERSHIP AFTER  
12          2012.—An election under subsection (a)—

13                 “(A) shall not be effective for any taxable  
14                 year beginning after December 31, 2012, and

15                 “(B) shall be treated as an election under  
16                 section 7701(a)(2)(B)(iii) for taxable years be-  
17                 ginning after such date.”.

18          (3) EFFECTIVE DATE.—The amendments made  
19          by this subsection shall apply to taxable years begin-  
20          ning after December 31, 2002.

21          (b) ELECTION BY CERTAIN CORPORATIONS TO BE  
22          TAXED AS PARTNERSHIP.—

23                 (1) IN GENERAL.—Paragraph (2) of section  
24                 7701 (defining partnership and partner) is amended  
25                 to read as follows:

1           “(2) PARTNERSHIP AND PARTNER.—

2                   “(A)     IN     GENERAL.—The     term  
3           ‘partnership’ includes a syndicate, group, pool,  
4           joint venture, or other unincorporated organiza-  
5           tion, through or by means of which any busi-  
6           ness, financial operation, or venture is carried  
7           on, and which is not, within the meaning of this  
8           title, a trust or estate or a corporation; and the  
9           term ‘partner’ includes a member in such a syn-  
10          dicate, group, pool, joint venture, or organiza-  
11          tion.

12                   “(B) ELECTION BY CORPORATION TO BE  
13          TAXED AS PARTNERSHIP.—

14                   “(i) IN GENERAL.—An eligible cor-  
15          poration may elect to be treated as a part-  
16          nership for purposes of this title.

17                   “(ii) ELIGIBLE CORPORATION.—For  
18          purposes of clause (i), the term ‘eligible  
19          corporation’ means an entity—

20                   “(I) which, without regard to this  
21          subparagraph, is a domestic corpora-  
22          tion no stock of which is readily  
23          tradable on an established securities  
24          market or otherwise, and

1                   “(II) which is not an ineligible  
2                   corporation (as defined by section  
3                   1361(b)(2)).

4                   “(iii) ELECTION AND TERMI-  
5                   NATION.—For purposes of this subpara-  
6                   graph, rules similar to the rules of section  
7                   1362 (other than subsections (a)(3), (d)(3)  
8                   and (4), and (e) thereof) shall apply.

9                   “(iv) EFFECT OF ELECTION.—No  
10                  gain or loss shall be recognized by the  
11                  shareholders or the corporation by reason  
12                  of an election under this subparagraph,  
13                  and rules similar to the rules of sections  
14                  1366(f)(2) and 1374 shall apply.

15                  “(v) DISTRIBUTIONS, ETC.—Each  
16                  partner shall include in gross income as a  
17                  dividend, any amount that would have been  
18                  so includible had the entity been an S cor-  
19                  poration during the period the entity was  
20                  treated as a partnership. Notwithstanding  
21                  the preceding sentence, the provisions of  
22                  subchapter K of chapter 1 shall apply to  
23                  determine the basis of any property dis-  
24                  tributed and the basis of any interest in  
25                  the partnership.”

1           (2) MODIFICATION TO TREATMENT OF SECTION  
2           1374 TAX FOR EARNINGS AND PROFITS PURPOSES.—  
3           Paragraph (2) of section 1366(f) is amended to read  
4           as follows:

5           “(2) TREATMENT OF TAX IMPOSED ON BUILD-  
6           IN GAINS.—

7           “(A) IN GENERAL.—The amount of the  
8           items of the net recognized built-in-gain taken  
9           into account under section 1374(b)(1) (reduced  
10          by any deduction allowed under section  
11          1374(b)(2)) shall not be taken into account  
12          under this section.

13          “(B) EARNINGS AND PROFITS.—The accu-  
14          mulated earnings and profits of the corporation  
15          shall be increased at the beginning of the tax-  
16          able year by the amount not taken into account  
17          under this section by reason of subparagraph  
18          (A) (determined without regard to section  
19          1374(b)(2)) reduced by the tax imposed by sec-  
20          tion 1374 (net of credits allowed).”

21          (3) EFFECTIVE DATE.—The amendments made  
22          by this subsection shall apply to taxable years begin-  
23          ning after December 31, 2002.

1 (c) STEP TRANSACTION DOCTRINE NOT TO APPLY  
2 TO PARTNERSHIP INCORPORATION FOLLOWED BY COR-  
3 PORATE REORGANIZATION.—

4 (1) IN GENERAL.—Section 351 is amended by  
5 redesignating subsection (h) as subsection (i) and by  
6 inserting after subsection (g) the following new sub-  
7 section:

8 “(h) SPECIAL RULE FOR PARTNERSHIPS WHICH IN-  
9 CORPORATE AND SUBSEQUENTLY REORGANIZE.—The  
10 step transaction doctrine and any similar doctrine shall  
11 not apply for purposes of determining whether the control  
12 requirement of subsection (a) is met in any case in  
13 which—

14 “(1) a partnership engaged in an active trade  
15 or business transfers substantially all of the property  
16 used in carrying on such trade or business to a cor-  
17 poration which is not publicly traded, and

18 “(2) such corporation subsequently enters into  
19 a reorganization under this chapter.”.

20 (2) EFFECTIVE DATE.—The amendment made  
21 by this subsection shall apply to transactions after  
22 December 31, 2002.

23 **SEC. 202. INCREASE IN EXPENSING UNDER SECTION 179.**

24 (a) INCREASE IN DOLLAR LIMITATIONS.—

1           (1) IN GENERAL.—Paragraph (1) of section  
2           179(b) (relating to dollar limitation) is amended to  
3           read as follows:

4           “(1) DOLLAR LIMITATION.—The aggregate cost  
5           which may be taken into account under subsection  
6           (a) for any taxable year shall not exceed \$25,000  
7           (\$40,000 in the case of taxable years beginning after  
8           December 31, 2012).”

9           (2) INCREASE IN PHASEOUT THRESHOLD.—  
10          Paragraph (2) of section 179(b) is amended by in-  
11          serting before the period “(\$325,000 in the case of  
12          taxable years beginning after December 31, 2012).”.

13          (b) INFLATION ADJUSTMENTS.—

14          (1) IN GENERAL.—Subsection (b) of section  
15          179 is amended by redesignating paragraphs (3) and  
16          (4) as paragraphs (4) and (5), respectively, and by  
17          inserting after paragraph (2) the following new  
18          paragraph:

19          “(3) INFLATION ADJUSTMENT.—In the case of  
20          any taxable year beginning in a calendar year after  
21          2004, the dollar amounts contained in paragraphs  
22          (1) and (2) which would (but for this paragraph)  
23          apply to such taxable year shall be increased by an  
24          amount equal to the product of—

25                  “(A) such dollar amount, and

1           “(B) the cost-of-living adjustment deter-  
2           mined under section 1(f)(3) for the calendar  
3           year in which the taxable year begins, deter-  
4           mined by substituting in subparagraph (B)  
5           thereof—

6                   “(i) ‘calendar year 2003’ for ‘calendar  
7                   year 1992’ with respect to the \$25,000  
8                   and \$200,000 amounts, and

9                   “(ii) ‘calendar year 2011’ for ‘cal-  
10                  endar year 1992’ with respect to the  
11                  \$40,000 and \$325,000 amounts.

12           If any amount after adjustment under the preceding  
13           sentence is not a multiple of \$1,000, such amount  
14           shall be rounded to the next lowest multiple of  
15           \$1,000.”

16           (2) CONFORMING AMENDMENT.—Subparagraph  
17           (B) of section 179(b)(5), as redesignated by para-  
18           graph (1), is amended by striking “paragraph (3)”  
19           and inserting “paragraph (4)”.

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

1 **SEC. 203. ROLLOVER OF PROPERTY HELD FOR PRODUC-**  
2 **TIVE USE OR INVESTMENT.**

3 (a) IN GENERAL.—Section 1031 (relating to ex-  
4 change of property held for productive use or investment)  
5 is amended to read as follows:

6 **“SEC. 1031. ROLLOVER OF PROPERTY HELD FOR PRODUC-**  
7 **TIVE USE OR INVESTMENT.**

8 “(a) NONRECOGNITION OF GAIN.—In the case of the  
9 sale of section 1031 property with respect to which the  
10 taxpayer elects the application of this section, gain from  
11 such sale shall be recognized only to the extent that the  
12 amount realized on such sale exceeds—

13 “(1) the cost of replacement section 1031 prop-  
14 erty purchased during the rollover period, reduced  
15 by

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

18 “(b) DEFINITIONS.—For purposes of this section—

19 “(1) SECTION 1031 PROPERTY.—

20 “(A) IN GENERAL.—The term ‘section  
21 1031 property’ means any property held for  
22 productive use in a trade or business or for in-  
23 vestment.

24 “(B) EXCEPTIONS.—The term ‘section  
25 1031 property’ shall not include the following:



1                   “(i) Stock in trade or other property  
2 held primarily for sale.

3                   “(ii) Stocks, bonds, or notes.

4                   “(iii) Other securities or evidences of  
5 indebtedness or interest.

6                   “(iv) Interests in a partnership.

7                   “(v) Certificates of trust or beneficial  
8 interests.

9                   “(vi) Choses in action.

10                   “(2) REPLACEMENT SECTION 1031 PROP-  
11 erty.—The term ‘replacement section 1031 prop-  
12 erty’ means, with respect to the sale of any section  
13 1031 property, other section 1031 property which is  
14 of a like kind to the section 1031 property sold.

15                   “(3) ROLLOVER PERIOD.—The term ‘rollover  
16 period’ means, with respect to the sale of any prop-  
17 erty, the period which begins 180 days before the  
18 date of such sale and ends on the earlier of—

19                   “(A) the date which is 180 days after the  
20 date of such sale, or

21                   “(B) the due date (determined with regard  
22 to extension) for the taxpayer’s return of the  
23 tax imposed by this chapter for the taxable year  
24 which includes the date of such sale.

1       “(c) BASIS ADJUSTMENTS.—If gain from any sale is  
2 not recognized by reason of subsection (a), such gain shall  
3 be applied to reduce the basis for determining the gain  
4 or loss of replacement section 1031 property purchased  
5 during the rollover period. If more than one replacement  
6 section 1031 property is purchased during the rollover pe-  
7 riod, such reduction shall be allocated among such prop-  
8 erties in such amounts as the taxpayer elects.

9       “(d) SPECIAL RULES FOR TRANSACTIONS BETWEEN  
10 RELATED PERSONS.—

11               “(1) SALE BY TAXPAYER.—If—

12                       “(A) the taxpayer sells property to a re-  
13 lated person,

14                       “(B) there is nonrecognition of gain under  
15 this section with respect to such sale (deter-  
16 mined without regard to this subsection), and

17                       “(C) before the date 2 years after the date  
18 of such sale the related person disposes of such  
19 property,

20 there shall be no nonrecognition of gain under this  
21 section to the taxpayer with respect to such sale,  
22 and any gain recognized by the taxpayer by reason  
23 of this subsection shall be taken into account as of  
24 the date on which the disposition referred to in sub-  
25 paragraph (C) occurs.

1           “(2) PURCHASE BY TAXPAYER.—If the tax-  
2 payer—

3           “(A) purchases property from a related  
4 person which is taken into account under sub-  
5 section (a)(1) (determined without regard to  
6 this subsection), and

7           “(B) disposes of such property before the  
8 date 2 years after the date of such purchase,  
9 such property shall not be taken into account under  
10 subsection (a)(1), and any gain recognized by reason  
11 of this subsection shall be taken into account on the  
12 date on which the disposition referred to in subpara-  
13 graph (B) occurs.

14           “(3) CERTAIN DISPOSITIONS NOT TAKEN INTO  
15 ACCOUNT.— For purposes of paragraphs (1)(C) and  
16 (2)(B), there shall not be taken into account any  
17 disposition—

18           “(A) after the earlier of the death of the  
19 taxpayer or the death of the related person,

20           “(B) in a compulsory or involuntary con-  
21 version (within the meaning of section 1033) if  
22 the transaction occurred before the threat or  
23 imminence of such conversion, or

24           “(C) with respect to which it is established  
25 to the satisfaction of the Secretary that neither

1 the transaction nor such disposition had as one  
2 of its principal purposes the avoidance of Fed-  
3 eral income tax.

4 “(4) RELATED PERSON.— For purposes of this  
5 subsection, the term ‘related person’ means any per-  
6 son bearing a relationship to the taxpayer described  
7 in section 267(b) or 707(b)(1).

8 “(5) SPECIAL RULE WHERE SUBSTANTIAL DIMI-  
9 NUTION OF RISK.—

10 “(A) IN GENERAL.—If subparagraph (B)  
11 applies to any property for any period, the run-  
12 ning of the period set forth in paragraph (1)(C)  
13 with respect to such property shall be sus-  
14 pended during such period.

15 “(B) PROPERTY TO WHICH PARAGRAPH  
16 APPLIES.—This subparagraph shall apply to  
17 any property for any period during which the  
18 holder’s risk of loss with respect to the property  
19 is substantially diminished by—

20 “(i) the holding of a put with respect  
21 to such property,

22 “(ii) the holding by another person of  
23 a right to acquire such property, or

24 “(iii) a short sale or any other trans-  
25 action.

1           “(6) TREATMENT OF CERTAIN TRANS-  
2           ACTIONS.—This section shall not apply to any trans-  
3           action which is part of a series of transactions struc-  
4           tured to avoid the purposes of this subsection.

5           “(e) SPECIAL RULES.—For purposes of this sec-  
6           tion—

7           “(1) EXCHANGES.—A contemporaneous ex-  
8           change by the taxpayer of section 1031 property for  
9           replacement section 1031 property shall be treated  
10          as a sale of such section 1031 property and a pur-  
11          chase of such replacement section 1031 property  
12          without regard to whether the taxpayer makes the  
13          election described in subsection (a). In the case of  
14          such an exchange, no loss shall be recognized.

15          “(2) CERTAIN PARTNERSHIPS.—An interest in  
16          a partnership which has in effect a valid election  
17          under section 761(a) to be excluded from the appli-  
18          cation of all of subchapter K shall be treated as an  
19          interest in each of the assets of such partnership  
20          and not as an interest in a partnership.

21          “(3) LIVESTOCK OF DIFFERENT SEXES.—Live-  
22          stock of different sexes are not property of a like  
23          kind.

24          “(4) FOREIGN REAL PROPERTY.—Real property  
25          located in the United States and real property lo-

1 cated outside the United States are not property of  
2 a like kind.

3 “(5) FOREIGN PERSONAL PROPERTY.—

4 “(A) IN GENERAL.—Personal property  
5 used predominantly within the United States  
6 and personal property used predominantly out-  
7 side the United States are not property of a like  
8 kind.

9 “(B) PREDOMINANT USE.—Except as pro-  
10 vided in subparagraphs (C) and (D), the pre-  
11 dominant use of any property shall be deter-  
12 mined based on—

13 “(i) in the case of the sale of any  
14 property by the taxpayer, the 2-year period  
15 ending on the date of such sale, and

16 “(ii) in the case of the purchase of  
17 any property by the taxpayer, the 2-year  
18 period beginning on the date of such pur-  
19 chase.

20 “(C) PROPERTY HELD FOR LESS THAN 2  
21 YEARS.—Except in the case of a sale or pur-  
22 chase which is part of a transaction (or series  
23 of transactions) structured to avoid the pur-  
24 poses of this subsection, only the periods the  
25 property was held by the taxpayer (or any re-

1           lated person) shall be taken into account under  
2           subparagraph (B).

3                   “(D) SPECIAL RULE FOR CERTAIN PROP-  
4           PERTY.—Property described in any subpara-  
5           graph of section 168(g)(4) shall be treated as  
6           used predominantly in the United States.”.

7           (b) PRESERVATION OF CERTAIN GAIN, LOSS, AND  
8           BASIS RULES FOR EXCHANGES.—

9                   (1) Section 1035 (relating to certain exchanges  
10          of insurance policies) is amended—

11                           (A) by striking subsection (d),

12                           (B) by redesignating subsections (b) and  
13                   (c) as subsections (e) and (f), respectively, and

14                           (C) by inserting after subsection (a) the  
15          following new subsections:

16          “(b) GAIN FROM EXCHANGES NOT SOLELY IN  
17          KIND.—If an exchange would be within the provisions of  
18          subsection (a), of section 1036(a), or of section 1037(a),  
19          if it were not for the fact that the property received in  
20          exchange consists not only of property permitted by such  
21          provisions to be received without the recognition of gain,  
22          but also of other property or money, then the gain, if any,  
23          to the recipient shall be recognized, but in an amount not  
24          in excess of the sum of such money and the fair market  
25          value of such other property.

1       “(c) LOSS FROM EXCHANGES NOT SOLELY IN  
2 KIND.—If an exchange would be within the provisions of  
3 subsection (a), of section 1036(a), or of section 1037(a),  
4 if it were not for the fact that the property received in  
5 exchange consists not only of property permitted by such  
6 provisions to be received without the recognition of gain  
7 or loss, but also of other property or money, then no loss  
8 from the exchange shall be recognized.

9       “(d) BASIS.—If property was acquired on an ex-  
10 change described in subsection (a), section 1036(a), or  
11 section 1037(a), then the basis shall be the same as that  
12 of the property exchanged, decreased in the amount of any  
13 money received by the taxpayer and increased in the  
14 amount of gain or decreased in the amount of loss to the  
15 taxpayer that was recognized on such exchange. If the  
16 property so acquired consisted in part of the type of prop-  
17 erty permitted by subsection (a), section 1036(a), or sec-  
18 tion 1037(a), to be received without the recognition of  
19 gain or loss, and in part of other property, the basis pro-  
20 vided in this subsection shall be allocated between the  
21 properties (other than money) received, and for the pur-  
22 pose of the allocation there shall be assigned to such other  
23 property an amount equivalent to its fair market value at  
24 the date of the exchange. For purposes of subsection (a)  
25 and section 1036(a), where as part of the consideration



1 to the taxpayer another party to the exchange assumed  
2 (as determined under section 357(d)) a liability of the tax-  
3 payer, such assumption shall be considered as money re-  
4 ceived by the taxpayer on the exchange.”.

5 (2) Section 83(g), section 424(b), section  
6 424(c)(1)(B), section 454(c)(2), paragraphs (1) and  
7 (2) of section 1036(c), and paragraphs (1) and (2)  
8 of section 1037(c) are each amended by striking  
9 “section 1031” and inserting “section 1035”.

10 (3) Paragraphs (1) and (2) of section 1037(b)  
11 are each amended by striking “section 1031(b)” and  
12 inserting “section 1035(b)”.

13 (c) CONFORMING AMENDMENTS.—

14 (1) Clause (i) of section 197(f)(2)(B) is amend-  
15 ed by inserting “(including any purchase taken into  
16 account under subsection (a)(1) thereof)” after  
17 “1031”.

18 (2) Paragraph (6) of section 453(f) is amended  
19 to read as follows:

20 “(6) LIKE-KIND EXCHANGES.—In the case of  
21 any sale or exchange to which section 1031 applies,  
22 the total contract price, the gross profit from such  
23 sale, and the amount of any payment (other than for  
24 purposes of subsection (b)(1)) shall be reduced to  
25 take into account any amount not recognized by rea-

1 son of section 1031. Similar rules shall apply in the  
2 case of an exchange which is described in section  
3 356(a) and is not treated as a dividend.”.

4 (3) BASIS LIMITATION FOR PLAYER CONTRACTS  
5 TRANSFERRED IN CONNECTION WITH THE SALE OF  
6 A FRANCHISE.—Paragraph (1) of section 1056(b) is  
7 amended to read as follows:

8 “(1) to any sale or exchange to which section  
9 1031 applies, and”.

10 (4) VALUATION OF CERTAIN FARM, ETC., REAL  
11 PROPERTY.—

12 (A) Clause (i) of section 2032A(e)(14)(C)  
13 is amended to read as follows:

14 “(i) QUALIFIED REPLACEMENT PROP-  
15 erty.—The term ‘qualified replacement  
16 property’ means any real property the ac-  
17 quisition of which results in the non-  
18 recognition of gain under section 1031 or  
19 1033.”.

20 (B) Subclause (I) of section  
21 2032A(e)(14)(C)(ii) is amended by inserting  
22 “sale or” before “exchange”.

23 (C) Subsection (i) of section 2032A is  
24 amended to read as follows:

1       “(i) REPLACEMENT OF QUALIFIED REAL PROP-  
2   ERTY.—

3               “(1) TREATMENT OF PROPERTY SOLD OR EX-  
4   CHANGED.—

5                       “(A) SALES AND EXCHANGES WITH NO  
6                       RECOGNITION OF GAIN.—If an interest in quali-  
7                       fied real property is sold or exchanged and no  
8                       gain is recognized under section 1031 by reason  
9                       of the acquisition of qualified replacement prop-  
10                      erty, no tax shall be imposed by subsection (c)  
11                      by reason of such sale or exchange.

12                     “(B) SALES AND EXCHANGES WITH PAR-  
13                     TIAL RECOGNITION OF GAIN.—Except as pro-  
14                     vided in paragraph (1), if an interest in quali-  
15                     fied real property is sold or exchanged and a  
16                     portion of the gain is not recognized under sec-  
17                     tion 1031 by reason of the acquisition of quali-  
18                     fied replacement property, the amount of the  
19                     tax imposed by subsection (c) by reason such  
20                     sale or exchange shall be the amount of tax  
21                     which (but for this paragraph) would have been  
22                     imposed on such sale or exchange under sub-  
23                     section (c)(1), reduced by an amount which—

24                               “(i) bears the same ratio to such tax,  
25                               as

1           “(ii) the fair market value of the  
2           qualified replacement property (determined  
3           as of the time or acquisition) bears to the  
4           fair market value of the qualified real  
5           property sold or exchanged (determined as  
6           of the time of disposition).

7           “(2) TREATMENT OF QUALIFIED REPLACEMENT  
8           PROPERTY.—For purposes of subsection (c)—

9           “(A) any interest in qualified replacement  
10          property shall be treated in the same manner as  
11          if it were a portion of the interest in the quali-  
12          fied real property which was sold or exchanged,

13          “(B) any tax imposed by subsection (c) by  
14          reason of the sale or exchange shall be treated  
15          as a tax imposed on a partial disposition, and

16          “(C) paragraph (6) of subsection (c) shall  
17          be applied by treating material participation  
18          with respect to the sold or exchanged property  
19          as material participation with respect to the  
20          qualified replacement property.

21          “(3) QUALIFIED REPLACEMENT PROPERTY.—  
22          For purposes of this subsection, the term ‘qualified  
23          replacement property’ means real property which is  
24          to be used for the qualified use set forth in subpara-  
25          graph (A) or (B) of subsection (b)(2) under which

1 the qualified real property sold in the qualified sale  
2 originally qualified under subsection (a).”.

3 (d) CLERICAL AMENDMENT.—The table of sections  
4 for part III of subchapter O of chapter 1 is amended by  
5 striking the item relating to section 1031 and inserting  
6 the following new item:

“Sec. 1031. Rollover of property held for productive use or invest-  
ment.”.

7 (e) EFFECTIVE DATE.—The amendments made by  
8 this section shall apply to transfers made after December  
9 31, 2002, in tax years ending after such date.

10 **SEC. 204. REPEAL OF COLLAPSIBLE CORPORATIONS.**

11 (a) IN GENERAL.—Subpart C of part II of sub-  
12 chapter C of chapter 1 (relating to collapsible corpora-  
13 tions) is hereby repealed.

14 (b) CLERICAL AMENDMENT.—The table of subparts  
15 for part II of subchapter C of chapter 1 is amended by  
16 striking the item relating to subpart C.

17 (c) EFFECTIVE DATE.—The amendments made by  
18 this section shall apply to sales, exchanges, and distribu-  
19 tions made after the date of the enactment of this Act.

20 **SEC. 205. REFERENCES TO GENERAL PARTNERS.**

21 (a) EXCLUSION OF CERTAIN ACTIVE BUSINESSES  
22 FROM AT RISK RULES.—Subclause (I) of section  
23 465(c)(7)(D)(ii) (defining qualified corporate partner) is  
24 amended to read as follows:

1                   “(I) such corporation is not pro-  
2                   hibited or limited under State law  
3                   from participation in the management  
4                   or business of the partnership.”.

5           (b) PAYMENTS TO RETIRING PARTNERS.—Subpara-  
6 graph (B) of section 736(b)(3) (relating to limitation on  
7 application of paragraph (2)) is amended to read as fol-  
8 lows:

9                   “(B) any portion of the retiring or de-  
10                  ceased partner’s distributive share of partner-  
11                  ship income was subject to tax under section  
12                  1401.

13          (c) FOREIGN CURRENCY TRANSACTIONS.—Subclause  
14 (I) of section 988(c)(1)(E)(v) is amended to read as fol-  
15 lows:

16                   “(I) CERTAIN GENERAL PART-  
17                  NERS.—The interest of a partner in  
18                  the partnership shall not be treated as  
19                  failing to meet the 20-percent owner-  
20                  ship requirements of clause (iii)(I) for  
21                  any taxable year of the partnership if  
22                  for the taxable year of the partner in  
23                  which such partnership taxable year  
24                  ends—

1                   “(aa) the partner is not lim-  
2                   ited as to participation in the  
3                   management or activity of the  
4                   qualified fund, and

5                   “(bb) such partner (and each  
6                   corporation filing a consolidated  
7                   return with such partner) had no  
8                   ordinary income or loss from a  
9                   section 988 transaction which is  
10                  foreign currency gain or loss (as  
11                  the case may be).”.

12           (d) SPECIAL VALUATION RULES FOR GENERATION-  
13 SKIPPING TAX.—Clause (ii) of section 2701(b)(2)(B) (re-  
14 lating to partnerships) is amended to read as follows:

15                   “(ii) in the case of a limited partner-  
16                   ship, the holding of any interest as a part-  
17                   ner who is not limited as to participation  
18                   in management or activity of the partner-  
19                   ship.”.

20           (e) TAX MATTERS PARTNER.—Paragraph (7) of sec-  
21 tion 6231(a) (defining tax matters partner) is amended  
22 to read as follows:

23                   “(7) TAX MATTERS PARTNER.—

24                   “(A) IN GENERAL.—The tax matters part-  
25                   ner of any partnership is—

1           “(i) the partner designated as the tax  
2 matters partner as provided in regulations,  
3 or

4           “(ii) if there is no partner who has  
5 been so designated, the partner having the  
6 largest profits interest in the partnership  
7 at the close of the taxable year involved  
8 (or, where there is more than 1 such part-  
9 ner, the 1 of such partners whose name  
10 would appear first in an alphabetical list-  
11 ing).

12           “(B) SELECTION BY SECRETARY.—If there  
13 is no partner designated under subparagraph  
14 (A)(i) and the Secretary determines that it is  
15 impracticable to apply subparagraph (A)(ii), the  
16 partner selected by the Secretary shall be treat-  
17 ed as the tax matters partner. The Secretary  
18 shall, within 30 days of selecting a tax matters  
19 partner under the preceding sentence, notify all  
20 partners required to receive notice under sec-  
21 tion 6223(a) of the name and address of the  
22 person selected.

23           “(C) RESTRICTION ON DESIGNATION OF  
24 PARTNER.—A partner may not be designated as  
25 a tax matters partner under subparagraph



1 (A)(i) unless such partner is not limited as to  
2 participation in management or activity of the  
3 partnership.”.

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

7 **SEC. 206. REFERENCES TO LIMITED PARTNERS.**

8 (a) LIMITED ENTREPRENEUR.—

9 (1) IN GENERAL.—Subparagraph (A) of section  
10 464(e)(2) (defining limited entrepreneur) is amend-  
11 ed by striking “than as a limited partner”.

12 (2) CONFORMING AMENDMENTS.—

13 (A) Section 464(c) is amended—

14 (i) by striking “limited partners or”  
15 in paragraph (1)(B),

16 (ii) by striking “a limited partner or”  
17 in paragraph (2).

18 (B) Section 1256 is amended—

19 (i) by striking “limited partners or”  
20 each place it appears in subsections  
21 (e)(3)(B) and (f)(4),

22 (ii) by striking “a limited partner or”  
23 in subsection (e)(3)(C), and

1 (iii) by striking “limited partner or”  
2 both places it appears in subsection  
3 (e)(4)(A)(i).

4 (C) Section 1258(d)(5)(C) is amended—

5 (i) by striking “limited partner or” in  
6 the matter preceding subclause (i),

7 (ii) by striking “limited partner’s (or  
8 limited entrepreneur’s) in subclause (i) and  
9 inserting “limited entrepreneur’s”, and

10 (iii) by striking “PARTNERS AND LIM-  
11 ITED” in the heading.

12 (b) PASSIVE LOSS RULES.—

13 (1) Subsection (h) of section 469 is amended by  
14 striking paragraph (2) and by redesignating para-  
15 graphs (3), (4), and (5) as paragraphs (2), (3), and  
16 (4), respectively.

17 (2) Subparagraph (A) of section 469(c)(7) is  
18 amended by striking the last sentence.

19 (3) Paragraph (6) of section 469(i) is amended  
20 by striking subparagraph (C) and by redesignating  
21 subparagraph (D) as subparagraph (C).

22 (4) Subsection (f) of section 772 (relating to  
23 special rules for applying passive loss limitations) is  
24 amended to read as follows:

1       “(f) SPECIAL RULES FOR APPLYING PASSIVE LOSS  
2 LIMITATIONS.—

3           “(1) IN GENERAL.—If any person holds an in-  
4       terest in an electing large partnership other than as  
5       a partner described in paragraph (3)—

6           “(A) paragraph (2) of subsection (c) shall  
7       not apply to such partner, and

8           “(B) such partner’s distributive share of  
9       the partnership items allocable to passive loss  
10       limitation activities shall be taken into account  
11       separately to the extent necessary to comply  
12       with the provisions of section 469.

13          “(2) EXCEPTION.—Paragraph (1) shall not  
14       apply to any items allocable to an interest held as  
15       a partner described in paragraph (3).

16          “(3) PARTNER DESCRIBED.—For purposes of  
17       this subsection, a partner is described in this para-  
18       graph if the partner is a person whose participation  
19       in the management or business activity of the part-  
20       nership is limited under applicable State law.”.

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

1 **SEC. 207. PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-**  
2 **ITAL EXCLUDED FROM NET EARNINGS FROM**  
3 **SELF-EMPLOYMENT.**

4 (a) IN GENERAL.—Paragraph (13) of section  
5 1402(a) is amended to read as follows:

6 “(13) there shall be excluded the distributive  
7 share of net income of a partner attributable to cap-  
8 ital;”.

9 (b) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-  
10 ITAL.—Section 1402 is amended by adding at the end the  
11 following new subsection:

12 “(1) PARTNERSHIP INCOME ATTRIBUTABLE TO CAP-  
13 ITAL.—

14 “(1) IN GENERAL.—For purposes of subsection  
15 (a)(13), the following amounts shall be treated as in-  
16 come attributable to capital—

17 “(A) the amount, if any, in excess of what  
18 would constitute reasonable compensation for  
19 services rendered by such partner to the part-  
20 nership, and

21 “(B) an amount equal to a reasonable rate  
22 of return on unreturned capital of the partner  
23 determined as of the beginning of the taxable  
24 year.

25 “(2) DEFINITIONS.—For purposes of paragraph  
26 (1)—

1           “(A) UNRETURNED CAPITAL.—The term  
2           ‘unreturned capital’ means the excess of the ag-  
3           gregate amount of money and the fair market  
4           value as of the date of contribution of other  
5           consideration (net of liabilities) contributed by  
6           the partner over the aggregate amount of  
7           money and the fair market value as of the date  
8           of distribution of other consideration (net of li-  
9           abilities) distributed by the partnership to the  
10          partner, increased or decreased for the part-  
11          ner’s distributive share of all reportable items  
12          as determined in section 702. If the partner ac-  
13          quires a partnership interest and the partner-  
14          ship makes an election under section 754, the  
15          partner’s unreturned capital shall take into ac-  
16          count appropriate adjustments under section  
17          743.

18          “(B) REASONABLE RATE OF RETURN.—A  
19          reasonable rate of return on unreturned capital  
20          shall equal 150 percent (or such higher rate as  
21          is established in regulations) of the highest ap-  
22          plicable Federal rate, as determined under sec-  
23          tion 1274(d)(1), at the beginning of the part-  
24          nership’s taxable year.

1           “(3) REGULATIONS.—The Secretary shall pre-  
2       scribe such regulations as may be necessary to carry  
3       out the purposes of this subsection.”.

4       (c) EFFECTIVE DATE.—The amendments made by  
5       this section shall apply with respect to services performed  
6       in taxable years beginning after December 31, 2002.

7       **SEC. 208. REPEAL OF ABILITY TO ELECT LARGE PARTNER-**  
8                           **SHIP REPORTING RULES.**

9       (a) IN GENERAL.—Paragraph (2) of section 775(a)  
10      (relating to election) is amended by adding at the end the  
11      following: “No election under this subsection shall be  
12      made after December 31, 2002.”.

13      (b) EFFECTIVE DATE.—The amendment made by  
14      this section shall apply to partnership taxable years begin-  
15      ning after December 31, 2002.

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